the CATO JOURNAL

AN INTERDISCIPLINARY JOURNAL OF PUBLIC POLICY ANALYSIS

GOVERNMENT, THE ECONOMY, AND THE CONSTITUTION

James M. Buchanan	Justification of the Compound Republic: The *Calculus* in Retrospect
Gordon Tullock	The *Calculus:* Postscript after 25 Years *Comment by* **Richard E. Wagner**
Dwight R. Lee	The *Calculus of Consent* and the Constitution of Capitalism
Thomas R. Dye	The Politics of Constitutional Choice
Peter H. Aranson	Procedural and Substantive Constitutional Protection of Economic Liberties
Robert L. Bish	Federalism: A Market Economics Perspective *Comment by* **David W. Rasmussen**
Richard L. Stroup	Reflections on Freedom, Fairness, and the Constitution
Richard A. Epstein	The Public Trust Doctrine

OTHER ARTICLES

Marilyn R. Flowers	Rent Seeking and Rent Dissipation: A Critical View
W. A. Kelly, Jr., Clark Nardinelli, and M. S. Wallace	Regulation of Insider Trading: Rethinking SEC Policy Rules
Clifton Perry	Tort Reform and the Market-Share Rule
Robert Craig Waters	Judicial Immunity vs. Due Process
John R. Lott, Jr.	Why Is Education Publicly Provided?
Carolyn L. Weaver	Support of the Elderly before the Depression
Richard Meyer and Bruce Yandle	The Political Economy of Acid Rain

VOLUME 7 NUMBER 2 • PUBLISHED BY THE CATO INSTITUTE • FALL 1987

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the CATO JOURNAL

VOLUME 7 NUMBER 2 • PUBLISHED BY THE CATO INSTITUTE • FALL 1987

Editor
JAMES A. DORN

Assistant Editor
CATHERINE ENGLAND

Production
DAVID LAMPO

EDITORIAL BOARD

TERRY L. ANDERSON
Montana State University

PETER H. ARANSON
Emory University

CHARLES W. BAIRD
California State University
at Hayward

T. E. BORCHERDING
Claremont Graduate School

YALE BROZEN
University of Chicago

KARL BRUNNER
University of Rochester

JAMES M. BUCHANAN
Center for Study of
Public Choice
George Mason University

ARTHUR A. EKIRCH
State University
of New York at Albany

RICHARD A. EPSTEIN
University of Chicago

STEVE H. HANKE
Johns Hopkins University

C. LOWELL HARRISS
Columbia University

FRIEDRICH A. HAYEK
University of Freiburg

JOSEPH P. KALT
Harvard University

LEONARD P. LIGGIO
Institute for
Humane Studies

WILLIAM A. NISKANEN
Cato Institute

SAM PELTZMAN
University of Chicago

ALVIN RABUSHKA
Hoover Institution
Stanford University

EARL C. RAVENAL
Georgetown University

VERNON L. SMITH
University of Arizona

ROLAND VAUBEL
Mannheim University

KAREN I. VAUGHN
George Mason University

RICHARD E. WAGNER
Florida State University

LAWRENCE H. WHITE
New York University

LELAND B. YEAGER
Auburn University

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The CATO JOURNAL (ISSN 0273-3072) is published in the spring/summer, fall, and winter by the Cato Institute, 224 Second Street SE, Washington, D.C. 20003. Annual subscriptions are $21.00 for individuals and $35.00 for institutions. Single copies are $7.00. Two-year subscriptions are $42.00 and three-year subscriptions are $63.00. Foreign subscribers should add $5.00 per year for regular delivery and $10.00 per year for airmail delivery.

Correspondence regarding subscriptions, changes of address, procuring back issues, advertising and marketing matters, etc., should be addressed to the Publications Department. All other correspondence, including requests to quote or reproduce material, should be addressed to the editor.

Unsolicited manuscripts cannot be returned and will be acknowledged only if accompanied by a stamped, self-addressed envelope. There is no submission fee. Articles should focus on specific public policy issues. Accepted manuscripts must conform to the CATO JOURNAL's style requirements. (A style sheet is available on request.)

Authors should submit three copies of their papers or communications to the editor. An abstract of no more than 250 words should also be included to aid referees. Manuscripts should have wide margins and be double-spaced throughout, including footnotes.

Unsolicited book reviews cannot be returned and will be acknowledged only if they are accepted for publication. They should conform to the above requirements, and should provide an in-depth analysis of major studies of public policy. Reviews should range from 800 to 1,000 words.

The views expressed by the authors of the articles are their own and are not attributable to the editor, the editorial board, or the Cato Institute.

The CATO JOURNAL is indexed and abstracted in the *Journal of Economic Literature, Current Contents/Social and Behavioral Sciences, Social Sciences Citation Index*, and the ABI/INFORM database. The CATO JOURNAL is available on microfilm from University Microfilms International, Ann Arbor, Michigan 48106.

Printed in the United States of America.

Copyright © 1987 by the Cato Institute.
All rights reserved.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

CATO JOURNAL • VOLUME 7 NUMBER 2 • FALL 1987

GOVERNMENT, THE ECONOMY, AND THE CONSTITUTION

Introduction 283

James M. Buchanan
Justification of the Compound Republic: The *Calculus* in Retrospect 305

Gordon Tullock
The *Calculus:* Postscript after 25 Years 313

Comment by **Richard E. Wagner** 323

Dwight R. Lee
The *Calculus of Consent* and the Constitution of Capitalism 331

Thomas R. Dye
The Politics of Constitutional Choice 337

Peter H. Aranson
Procedural and Substantive Constitutional Protection of Economic Liberties 345

Robert L. Bish
Federalism: A Market Economics Perspective 377

Comment by **David W. Rasmussen** 397

Richard L. Stroup
Reflections on Freedom, Fairness, and the Constitution 403

Richard A. Epstein
The Public Trust Doctrine 411

OTHER ARTICLES

Marilyn R. Flowers
Rent Seeking and Rent Dissipation: A Critical View 431

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

William A. Kelly, Jr., Clark Nardinelli, and Myles S. Wallace
Regulation of Insider Trading: Rethinking SEC Policy Rules 441

Clifton Perry
Tort Reform and the Market-Share Rule 449

Robert Craig Waters
Judicial Immunity vs. Due Process: When Should a Judge Be Subject to Suit? 461

John R. Lott, Jr.
Why Is Education Publicly Provided? A Critical Survey 475

Carolyn L. Weaver
Support of the Elderly before the Depression: Individual and Collective Arrangements 503

Richard Meyer and Bruce Yandle
The Political Economy of Acid Rain 527

BOOK REVIEWS

A Conflict of Visions
Thomas Sowell
Reviewed by **Viktor Vanberg** 547

The Catholic Bishops and the Economy: A Debate
Douglas Rasmussen and James Sterba
Reviewed by **Paul Heyne** 551

Impulse to Revolution in Latin America
Jeffrey W. Barrett
Reviewed by **Ted Galen Carpenter** 552

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

INTRODUCTION

GOVERNMENT, THE ECONOMY, AND THE CONSTITUTION

James A. Dorn

> If industry and labor are left to take their own course, they will generally be directed to those objects which are the most productive, and this in a more certain and direct manner than the wisdom of the most enlightened Legislature could point out. . . . [A]ll are benefited by exchange, and the less this exchange is cramped by Government, the greater are the proportions of benefit to each.
>
> —James Madison[1]

Public Choice and the Constitution

The major question addressed by the Framers of the U.S. Constitution—particularly James Madison, who Robert Rutland (1987) has called "The Founding Father"—was how best to secure individual rights while providing for republican government. In choosing a *constitutional* democracy, Madison and the other Framers recognized the benefits of a rule of law. Such a rule would protect property, broadly conceived, and in so doing allow the principle of voluntary exchange, or what James Buchanan (1983, p. 8) has called the "principle of spontaneous order," to facilitate social coordination and generate mutually beneficial gains from trade.

The modern public choice school and its founding fathers, James Buchanan and Gordon Tullock, have shifted attention from the narrow economic problem of selecting the best means to attain a given end to the problem of classical political economy, namely, selecting from among alternative rules those that best set the framework for the emergence of a spontaneous market order, which will increase rather than diminish individual and social wealth.

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.

[1]Speech in First Congress, 9 April 1789; cited in Padover (1953, pp. 269–70).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Public choice theory rejects the organic view of the state, accepts the methodological individualism of the market paradigm, and models "politics as exchange." Individuals are assumed to be rationally self-interested both in their private and public choices. The "public choice perspective," according to Buchanan (1983), is essentially a "constitutional perspective," since it emphasizes the rules or constraints shaping individual incentives and behavior, and the process of coordination under alternative rules. In Buchanan's words (1983, pp. 10–11):

> The *constitutional* perspective . . . emerges naturally from the politics-as-exchange paradigm or research program. To improve politics, it is necessary to improve or reform the *rules*, the framework within which the game of politics is played. There is no suggestion that improvement lies in the selection of morally superior agents, who will use their powers in some "public interest." . . . [T]he public choice perspective leads directly to attention and emphasis on rules, on constitutions, on constitutional choice, on choice among rules.

The problem of public choice thus becomes one of constitutional choice, that is, of finding the set of rules that will provide mutually beneficial *political* exchanges analogous to the operation of the principle of spontaneous order in the context of private choice. The roots of the public choice perspective therefore go directly to the constitutional vision of Madison and the Framers. As Buchanan (1983, p. 14) notes:

> When persons are modelled as self-interested in politics, as in other aspects of their behavior, the constitutional challenge becomes one of constructing and designing framework institutions or rules that will, to the maximum extent possible, limit the exercise of such interest in exploitative ways and direct such interest to furtherance of the general interest. It is not surprising, therefore, to discover the roots of a public choice perspective . . . in the writings of the American Founders, and most notably in James Madison's contributions to *The Federalist Papers*.

With the 25th anniversary of *The Calculus of Consent* (1962) and the bicentennial of the U.S. Constitution, it is an opportune time to reconsider the economics and politics of constitutional choice, and the effect of that choice on individual rights and freedom. The first eight papers in this volume address the problem of constitutional choice, broadly understood, and are the product of the Third Annual Critical Issues Symposium, "Government, the Economy, and the Constitution," sponsored by the **Florida State University Policy Sciences Program**, March 5–7, 1987. By reexamining the "logical foun-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

dations of constitutional democracy"—the subject of the *Calculus*—and the interrelationship of the state, the market, and the constitutional order, these papers will help shed light on what Buchanan (1987, p. 250) sees as "the continuing question of social order," namely: "How can we live together in peace, prosperity, and harmony, while retaining our liberties as autonomous individuals who can, and must, create our own values?" Moreover, by improving our understanding of what F. A. Hayek (1960) has called "the constitution of liberty," these papers will help pave the way for meaningful constitutional reform.

The Logic of Constitutional Choice

Writing over three decades ago, Rutledge Vining (1956, p. 11) emphasized that "every economic problem can be regarded as a problem of finding an optimum set of rules of action," or more fundamentally, "how different rules of action would work out" in repetitive trials. The interesting economic problem for Vining, as for Buchanan and Tullock, is not the problem of allocating scarce means to achieve a well-defined end, but rather the problem of social organization, that is, "the problem of finding a better-working system of rules" (p. 14). This is the problem of political economy, and unlike the allocative problem confronting the individual consumer or firm, Vining (p. 15) notes that the problem of rule selection is a problem of collective or constitutional choice requiring "popular understanding" and "the joint action of all the members of the society." In making a constitutional choice, or a choice among alternative systems of rules, Vining (p. 18) observes that "the members of the society must reach a consensus"; thus, "the technical problem . . . is that of facilitating the social inter-action and communication leading to a consensus." The maximization model applied to the narrow allocation problem will not easily fit here because, as Vining (p. 18) points out, "There being no end for which the society is a means, there is no defined criterion which technicians can apply to designate an 'optimum' system." Consensus itself is the only reliable guide to the value of constitutional change.

Vining's view of the economic system as "a system of legislative constraints upon individual action" (p. 14) and his insistence that the relevant problem facing policymakers is that of selecting better rules for social and economic coordination are shared by Buchanan and Tullock in the *Calculus*.[2] Moreover, like Vining (see pp. 18–20),

[2]Reflecting on Vining's influence, Buchanan and Tullock (1962, p. 210) state: "[T]he fact that policy-makers always choose among organizational rules and not among 'allo-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Buchanan and Tullock accept universal consent as the appropriate criterion for determining whether a change in the "rules of the game" will be socially beneficial. Likewise, they afford individual freedom a central role in their normative theory of constitutional choice.[3] In particular, Buchanan and Tullock advance the idea that under the condition of individual freedom and behind a "veil of uncertainty," rational, utility-maximizing individuals will agree to constrain themselves by accepting a set of rules (a "constitution") delimiting certain actions (such as the taking of private property without compensation) in order to increase long-run stability (predictability) of the economic, political, and social system. For them, "it is rational to *have a constitution*," that is, "for the individual to choose more than one decision-making rule for collective choice-making" (1962, p. 81). Indeed, Buchanan and Tullock (p. 305) expect something close to the constitutional democracy chosen by the Framers to emerge from their "economic approach" to constitutional choice. Weighing the costs of alternative rules, individuals voluntarily submit themselves to a rule of law at the level of constitutional choice because there are gains from this political exchange, just as there are gains from free trade.

The unanimity rule plays a unique role in constitutional choice and is adopted by Buchanan and Tullock as the norm for justifying constitutional change. Accordingly, they write: "Only if a specific

---

cations' is often forcefully made by Professor Rutledge Vining. Our discussion of the constitutional calculus makes Vining's criticism of the orthodox or standard discussion of policy norms quite meaningful."

[3]Vining (1956, pp. 18–20) notes that individual freedom is an essential assumption of classical political economy—and hence of constitutional choice. The acceptance of this assumption implies that each individual has an implicit obligation to respect the equal freedom of others. According to Vining (pp. 18–19):

> To be free to act as one chooses and at the same time to recognize the freedom of others to do likewise can only mean that all participate equally in setting the constraints upon individual action. For no one is free unless all abide by the rules of conduct which all can be brought to accept as appropriate constraints upon individual action. . . . To require of each individual that he takes no action which impairs the freedom of any other individual is to accept the moral principle that no individual should treat another simply as a means to an end. Each individual chooses the rules and principles for the guidance of his conduct, but he does so under the general principle that no rule of action will be adopted which could not be universally adopted by all individuals. . . . Hence, when we think of a free and rational individual we do not envisage an individual unconstrained by law but rather an individual who acts in accordance with rules of conduct he has chosen. . . . [These] ideas . . . were presented as implications of the concept of individual freedom at about the time this nation was formed; and the political structure of the U.S.A. reflects this conception of freedom and rationality.

The upshot of Vining's argument is that a legitimate constitution requires consensus and hence freedom of choice (cf. Pilon 1981).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

constitutional change can be shown to be in the interest of all parties shall we judge such a change to be an 'improvement.' " (p. 14). In accepting the unanimity rule as a justificatory criterion for constitutional choice, Buchanan and Tullock follow in the footsteps of their predecessor Knut Wicksell, who in looking at the narrower problem of determining tax shares for specific spending programs argued that justice requires unanimous consent. "In the final analysis," wrote Wicksell ([1896] 1958, p. 90), "unanimity and fully voluntary consent in the making of decisions provide the only certain and palpable guarantee against injustice in tax distribution."

What Buchanan and Tullock did was to extend Wicksell's "just principle of taxation" to encompass constitutional choice, and in so doing changed the way in which economists and political scientists view the relationship between economics and politics.[4] By placing the Wicksellian unanimity rule at the heart of constitutional choice, Buchanan and Tullock dethroned the majority rule, showing that it had no unique position in the logic of constitutional choice (see p. 81). Moreover, they made it clear that if majoritarian impulses were not held in check by constitutional limits on the power of government, private rights would be eroded by rent-seeking activity, a danger well understood by the Framers.

Applying their economic approach to constitutional choice, Buchanan and Tullock (p. 88) argue that in the absence of decisionmaking costs, the unanimity rule is the only rule that would minimize the external costs of collective choice to each individual. Moreover, like Wicksell, they argue that "full consensus . . . among all members of the social group seems . . . to be the only conceivable test of the 'rightness' of the choices made" (p. 250). Regarding the place of majority rule in a constitutional setting, they state: "[The] postulated unanimity rule for ultimate constitutional decisions allows us to divorce much of our analysis from the long and continuing debate concerning the validity of majority-rule as an absolute doctrine of popular sovereignty" (p. 250).

Buchanan and Tullock adhere to the unanimity rule as a normative criterion for social choice, but in introducing collective decisionmaking costs find that their "costs approach" to social choice yields a variety of rules for collective action, including majority rule. Rational individuals at the level of constitutional choice will accept less than

[4]See Buchanan's Nobel Prize lecture (1987), in which he acknowledged the strong influence Wicksell had on his general approach to economics as constitutional choice, particularly in the *Calculus*. Buchanan notes (p. 248, n. 2): "In my own retrospective interpretation, the shift of the Wicksellian construction to the constitutional stage of choice was the most important contribution in *The Calculus of Consent*."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

unanimous consent for post-constitutional, operational decisions in order to minimize the present value of the expected costs of government.[5] Expediency, not principle, moves individuals to opt for less than unanimity in the post-constitutional state.[6] Rules other than unanimity "will be rationally chosen," argue Buchanan and Tullock (p. 96), "not because they will produce 'better' collective decisions (they will not), but rather because, on balance, the sheer weight of the costs involved in reaching decisions unanimously dictates some departure from the 'ideal' rule." Again, commenting on the place of majority rule, they write (p. 96):

> Many scholars seem to have overlooked the central place that the unanimity rule must occupy in any normative theory of democratic government. We have witnessed an inversion whereby . . . majority rule has been elevated to the status which the unanimity rule should occupy. At best, majority rule should be viewed as one among many practical expedients made necessary by the costs of securing widespread agreement on political issues when individual and group interests diverge.

An important implication of Buchanan and Tullock's economic theory of constitutional choice is that as individuals move away from unanimity and toward a less inclusive rule for collective choice, such as simple majority, decisionmaking costs decrease; yet, at the same time, there is an increase in the risk that individual rights will be attenuated (p. 72). Thus, Buchanan and Tullock argue that in those cases where the *external costs* to an individual from collective action are likely to be large—as in the area of personal and property rights—relative to the decisionmaking costs, the rational individual will require unanimity or near-unanimity before binding himself at the constitutional level (see pp. 71–74, 82). To wit, in cases where an

[5]When both the external costs and decisionmaking costs to the individual are taken into account, rational constitutional calculus dictates that each individual "*minimize* the present value of the expected costs that he must suffer. He will do so by minimizing the *sum* of the expected external costs and expected decision-making costs" (Buchanan and Tullock 1962, p. 70).

[6]Cf. Vining (1956, p. 19, n. 1) on the question of expediency versus principle in constitutional choice:

> Is a majority vote to be interpreted as an expression of 'consensus'? The answer to this . . . question is clearly no. The majority rule is no more than a device constituting a part of a political procedure which is accepted by the individual. There is no implication that he accepts as right and just a particular law which results from a particular application of this device. It is understood that the resulting law is only tentative, that the search for consensus continues, that the rule will be applied to proposed revisions of the law at the next opportunity, and that the joint action taken was expedient action rather than necessarily right. The individual accepts the political procedure for seeking a consensus and by implication the results which may be observed at any particular point in time.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

individual recognizes that collective action may impose large external costs on him by attenuating his property rights, "he will tend to place a high value on the attainment of his consent, and he may be quite willing to undergo substantial decision-making costs in order to insure that he will, in fact, be reasonably protected against confiscation" (Buchanan and Tullock, p. 74). This implication is certainly supported by the Framers' decision to remove what they considered "natural rights"—rights to life, liberty, and property—from the democratic process so that majority rule would not undermine individual freedom.[7]

In sum, the logic of constitutional choice is at base the logic of voluntary exchange; and like private choice, the collective choices made at the constitutional level are to be judged by their consistency with the rule of universal consent. To the extent individual freedom is attenuated, constitutional choice will be nonoptimal from the viewpoint of the individuals constrained by it. In a world of positive collective decisionmaking costs, individuals are likely to adopt an array of rules for social choice. Consequently, the Framers' choice of a constitutional democracy is fully compatible with the public choice/constitutional perspective of the *Calculus of Consent*.

The logic of constitutional choice is further examined in this volume by James Buchanan, Gordon Tullock, Dwight Lee, and Thomas Dye. Buchanan and Tullock take a retrospective view of the *Calculus*, reexamining some of its major themes and its impact on constitutional theory and reform; Lee explores the relationship between constitutional democracy and capitalism; and Dye examines the political nature of constitutional choice.

Constitutional Democracy and the Calculus of Consent

In his paper, *James Buchanan* compares the public choice/constitutional perspective of the *Calculus* to the early work of social choice theorists such as Kenneth Arrow (1951), Duncan Black (1958), and Anthony Downs (1957), and to the orthodox views of political scientists and others in order to highlight the significance of his and Tullock's pioneering work. The distinctive feature of the *Calculus*,

[7]Cf. West Virginia State Board of Education v. Barnette (319 U.S. 624, 638 [1943]), where the majority held:

> The very purpose of a Bill of Rights was to withdraw certain subjects from the vicissitudes of political controversy, to place them beyond the reach of majorities and officials and to establish them as legal principles to be applied by the Courts. One's right to life, liberty, and property, to free speech, a free press, freedom of worship and assembly, and other fundamental rights may not be submitted to vote; they depend on the outcome of no elections.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

according to Buchanan, is that it was the first attempt to treat politics as exchange within the framework of utility maximization at the level of individual constitutional choice; and this novel economic approach to social choice differed from prevailing models by using the "individualistic calculus" of *consent* as a justificatory criterion for evaluating alternative rules for collective action. As such, the *Calculus* shifted attention from the problems of instability and inconsistency inherent in majority rule to the problem of explaining the rationale for collective action and evaluating rules for collective decisionmaking using the unanimity rule as a benchmark, since that is the only rule consistent with individual freedom.

Buchanan notes the importance of the thought of Wicksell and Vining in shaping his ideas, especially in the use of methodological individualism, the extension of the principle of exchange to politics, and in the replacement of majority rule by unanimous consent in developing a logic of constitutional choice. In the *Calculus*, Buchanan and Tullock were interested in protecting individual rights against the state, and constructed an "economic theory of constitutions" showing why rational individuals have an incentive to move toward a constitutional democracy. It was in providing a logical foundation for constitutional choice, based on several key economic principles, that the *Calculus* established itself as a classic work in the field of constitutional economics. One other important innovation in that work was the introduction of the "veil of uncertainty" concept, which Buchanan notes is similar to John Rawls's (1971) "veil of ignorance" concept; the difference being that Buchanan and Tullock used their concept in a generalized fashion to rule out certain outcomes in the choice of collective decisionmaking rules, whereas Rawls used his concept to generate specific rules of justice (wrongly so, in Buchanan's opinion).

Although there have been some shifts to the public choice/constitutional perspective, the view of "politics as pure conflict" and "politics as the quest for truth and light," observes Buchanan, is still widely held. What is needed, he argues, is better understanding of the interconnectedness of "the institutions of voluntary exchange, the choice among constitutional rules, and the operations of ordinary politics within such rules"—and hence a return to the "social contract tradition" of the Framers.

Gordon Tullock, in his paper, points to the dearth of new research in the areas of constitutional theory and constitutional reform. In particular, he would like to see more comparative constitutional studies and additional work on how existing rules for collective

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

choice can be improved. The problems of rent seeking and the "self-enforcing constitution" continue to plague the United States and other constitutional democracies. In his opinion, there really has been no satisfactory explanation of the demise of the Framers' Constitution, the dramatic increase in the power of the federal government relative to the states, and the emergence of the welfare state. Tullock, however, pinpoints two likely sources: the rise of the modern civil service as a strong special interest group and the Supreme Court's increased power to change the effective constitution without the consent of either Congress or the public. The result has been a growth in the federal government's power far beyond that envisioned by the Framers.

To stem the growth of the federal government's power and the redistributive state, Tullock suggests changing the incentive structure within government so that self-interested politicians will have an incentive to limit their predatory behavior. One possibility is to move toward a greater use of super-majority voting rules and hence toward consensus in making fiscal choices. This would require amending the Constitution. However, if the logic of the *Calculus* is correct, the rising costs of government and the increasing public debt should provide strong incentives for reaching a consensus on meaningful constitutional reform, permitting the amendment process to go forward. That so little progress has occurred in the areas of constitutional theory and reform over the last 25 years is disappointing to Tullock, but this only means that Madison's work has yet to be fully done, and that the logic of constitutional choice needs to be more fully applied.[8]

Capitalism and the Constitution of Liberty

Although there is no explicit discussion of capitalism or its relation to constitutional order in the *Calculus*, whose purpose was to look at the "*political* organization of a society of free men" (1962, p. v),

[8]One recent proposal for constitutional reform, which takes the public choice/constitutional perspective into mind, is William Niskanen's (1988b) recommendation for amending the Constitution so as to constrain the growth of government. His proposed amendment would require a super-majority on bills calling for increases in the federal government's taxing and borrowing powers. The proposed amendment is clear and simple, and encompasses the following four points: (1) "Congress may not increase the limit on the public debt of the United States without the approval by two-thirds of the total members of each House of a bill addressed solely to this subject"; (2) "Congress may not levy a new tax or increase the rate or base of an existing tax without the approval by two-thirds of the total members of each House"; (3) "The provisions of this article shall be suspended during any fiscal year during which a declaration of war is in effect"; and (4) "This article is effective beginning with the second fiscal year after ratification."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Dwight Lee holds that a better appreciation of the market system can be gained from studying the logic of constitutional choice. In his paper, he brings out the close ties between politics and economics, noting that "Every economy is a political economy and it is impossible to understand an economic system without taking into consideration the political environment within which that system operates."

Since the principle of voluntary exchange (unanimous consent) rests at the core of a market system, a constitutional order based on the same principle reinforces the logic of the market. Moreover, under a stable rule of law protecting private property and freedom of contract, individuals will have the freedom of choice necessary for the smooth operation of a market price system. As such, there is a close connection between capitalism and the "constitution of liberty." Lee discusses these ideas and remarks that without effective constraints on government power, and hence on majority rule, the political stability necessary for an effective capitalist economic order will be absent. Government intervention and rent seeking will then distort relative prices and upset the process of social and economic coordination. Lee's point is simply that markets operate best when government is least intrusive and therefore assumes primarily a protective rather than a redistributive role.

For Lee, it is largely immaterial whether the Framers intended to promote a capitalist economic order.[9] What is important is that they sought to limit the coercive power of government, and in so doing set the basis for a viable market order.[10] As long as there are effective constraints on government's predatory activities, argues Lee, the free market system will flourish, regardless of the Framers' original intent concerning the market order. Conversely, Lee cautions that as the property foundations of the market economy are weakened by extralegal changes in the effective constitution (that is, changes occurring outside the formal amendment process), the capitalist order itself will languish as an engine for wealth creation. In his opinion, "We would be better served if our current crop of politicians were less involved in 'promoting' capitalism and more involved in limiting the scope of government."

[9]Whether the Framers intended a capitalist system is uncertain, though probable—given their familiarity with, and general acceptance of, classical political economy. See, for example, Madison's quote at the beginning of the paper; see also Dorn (1988, pp. 87–92).

[10]Cf. Niskanan (1988a, p. xii): "The Framers may not have shared a common vision about the economic system. There should be no doubt, however, that the Constitution was designed to provide a strong but limited federal role, free trade among the states, and the security of private property—however the intent of the Framers may have been changed by subsequent interpretation."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Political Nature of Constitutional Choice

Thomas Dye, in his paper, expresses the view that although we have acquired an understanding of the "*logic* of collective choice," there is still much to learn about the "*politics* of collective choice." The interesting question for Dye, and one that has not in his opinion been sufficiently explored by the *Calculus,* is: What factors shape an individual's decision regarding collectivization? Although he appreciates the usefulness of Buchanan and Tullock's "cost approach to collective action" and the power of the utility maximization postulate in explaining constitutional choice, he nonetheless argues that the choice between private and collective action—that is, between organizing decisionmaking along the lines of the market or the state—is at bottom a "*political* choice" shaped by a complexity of factors, not solely individual self-interest. Among the factors that need to be examined, Dye lists the public's perception of justice, fairness, and equality as being of major importance. In particular, changes in popular conceptions of justice can affect the collective choice between market and government organization.

From a real world perspective, Dye also questions the emphasis public choice economists place on rational individual consent as the basis for constitutional choice. While he sees consent as a legitimate moral principle by which to judge collective action, Dye observes that in reality "political economies" are not the product of a consensual process. Social contract theory, says Dye, was never intended to serve as a practical guide for collective decisionmaking but rather as a moral principle to evaluate the legitimacy of government action. Thus, Dye reiterates his opinion that public choice theory can carry one only so far in understanding constitutional choice.

As a political scientist, Dye is interested in how public opinion on basic constitutional questions is shaped. Surveys show that individuals use different criteria to evaluate the market (private choice) and the government (public choice). Individuals tend to think in terms of self-interest when they judge the market, notes Dye, but in terms of the public interest when they judge government, which after all is an institution for collective choice. People's perceptions are important, observes Dye, because if individuals view the market as unjust, political choices will be made that replace the voluntary market system with increased collectivization, fueling a welfare state that is less efficient at producing wealth. This, of course, has been the experience of postwar democratic governments, and it is the dynamics of this political process and the "political foundations of market economics" that need further investigation, according to Dye.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Public choice theory, argues Dye, can help shed light on collective decisions regarding the role of the market and the state, because the assumption of rational self-interest describes a powerful force driving human action. But in his opinion, it is wrong to focus exclusively on self-interest as the prime mover in collective choice. He therefore calls for "research into the wide range of human motivations that shape societies," with the hope that this will improve our understanding of the political aspects of constitutional choice.

Constitutional Protection of Economic Liberties

Peter Aranson examines the role of the federal judiciary, especially the Supreme Court, in protecting economic liberties. He argues that the Framers provided both procedural and substantive safeguards against the erosion of economic rights. Indeed, for roughly the first 150 years following ratification, the Constitution's provisions for limiting government and protecting economic rights pertaining to property, contracts, and commerce worked reasonably well in constraining the redistributive state.[11] In the last 50 years, however, the Framers' vision of the Constitution as a "charter for limited government" has been blurred by an activist legislature and a Supreme Court unwilling to apply judicial review to cases involving attenuation of economic rights; and with the demise of substantive economic due process, members of Congress have been free to enact virtually any economic and social legislation they wish as long as it is deemed in the "public interest."[12]

Aranson traces the Court's failure to act as an effective bulwark against legislative activism in the area of economic rights to its failure to correctly interpret the economic provisions of the original Constitution and Bill of Rights, as well as to its failure to appreciate the

[11]For a discussion of the rise of the redistributive state, see Dorn (1986, and the references therein). Using *Munn v. Illinois* (94 U.S. 126 [1877]) as a watershed, Niskanen (1985, pp. 3–4) argues convincingly that "for nearly a century after the Constitution was ratified, as prescribed, by a unanimity of the states, there was relatively little controversy about the limits on federal powers and only a small amount of transfers consistent with the enumerated powers." The watershed chosen for the 150-year period is *West Coast Hotel Co. v. Parrish* (300 U.S. 379 [1937]), which marked the end of substantive economic due process (see Dorn 1987, p. 5).

[12]See, for example, Epstein (1984, 1985a), Pilon (1985), and Siegan (1980). Epstein (1984) notes:

> In economic matters too, the judicial surrender to legislative faction diverts resources from the production of wealth to the transfer of wealth. It promotes political division that threatens the economic foundations of a stable, free and democratic society. The connection between politics and markets, so well understood by the Founding Fathers, has been all but fogotten today.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

perversities of the democratic process, as it is driven by majority rule and special interests. In his paper, he examines the shortcomings of the three major judicial approaches to constitutional interpretation as they relate to economic liberties and argues for a return to the principles of justice that guided the Framers, and hence to the effective Constitution that was meant to safeguard individual property rights against rampant majoritarianism as well as organized interests. His view is therefore similar to the "constitutional perspective" of Buchanan and Tullock, and to the "*principled* judicial activism" position of Richard Epstein (1985a, 1985b) and Stephen Macedo (1986).

According to Aranson, the three dominant views of the constitution—the interpretivist view, the noninterpretivist view, and the proceduralist view—have all failed to prevent the attenuation of economic rights, as understood by the Framers. The rent-seeking process has not been stemmed by any of these three approaches to constitutional interpretation: the interpretivist view places undue weight on the majoritarian process; the noninterpretivist view turns the Court into an activist policymaking body; and the proceduralist view, while it occasionally protects minorities against majorities, does nothing to protect majorities against organized interest groups. As such, Aranson finds that all three theories miss the mark: each lacks a constitutional vision that connects up directly with the procedural and substantive protections inherent in the Framers' Constitution.

In contrast to the conventional approaches to judicial interpretation of economic rights, Aranson would neither overextend majoritarianism nor bend the Constitution to create new "rights" that give special interests privileged positions vis-à-vis the majority. Instead, as a "principled interpretivist," he would have the Court look to the Framers' Constitution, which affords equal protection to economic and noneconomic rights, and thus secure the equal rights of each individual to his life, liberty, and property. Although these rights precede the state and are inherent in the "higher-law" background of the Constitution (see Dorn 1988), Aranson looks to the document itself and argues that it is clear that the Framers sought to limit government and protect the property right. The Court's duty, therefore, is to provide *substantive* protection to economic liberties and in so doing restore what Niskanen (1988a) has called the "economic constitution." Economic liberties would then be taken out of the political arena and again be afforded their status as fundamental civil rights.[13]

[13]Siegan (1985, p. 289) writes: "The most important civil rights for the framers of the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

With equality under the "law of liberty," enforced by a vigilant Supreme Court, both the rights of minorities and majorities would be protected from erosion by the political branches of government. For Aranson, then, "The time has come for the Court to recognize the Constitution's full protection of economic liberties." If the Court fails in this constitutional and moral duty, either by excessive restraint or excessive (unprincipled) activism, both economic and noneconomic rights will be jeopardized with the further growth of the redistributive state.

Extending the Market Model: The Case for Federalism

It is a well-known proposition in microeconomics that under certain conditions competition is socially beneficial in directing resources to their highest-valued uses. Moreover, Hayek (1945, 1946, 1968) has shown that when viewed in terms of a process for the discovery and transmission of useful information, the competitive market process performs a coordinating function that cannot be duplicated by governmental planning. In Hayek's view, the relevant notion of competition is not the textbook ideal of perfect competition but rather the procedural view; and the test of a competitive market *process* is open entry, not the entire package of conditions required for perfect competition. With private property rights and open markets, relative prices can perform their information and incentive functions to successfully coordinate individual plans and efficiently allocate resources to satisfy the consumers' preferences. When Hayek's procedural model of market competition is transferred to the political model of federalism, interesting implications can be drawn about the federalist system as an integral part of constitutional democracy.

In his paper, *Robert Bish* uses the "logic of market economics to understand federalism," and offers proposals for improving it. He finds various similarities between the political model of federalism and the paradigm of market exchange: both accept self-interest as an important force motivating individual action; both recognize the information costs associated with exchange; both emphasize the socially beneficial role of competition in coordinating individual plans and in satisfying individual preferences; both point to the inefficiency of monopoly; and both recognize that individual rights and wealth creation will be enhanced by constraining predation

original Constitution, the Bill of Rights, and the Fourteenth Amendment were those of life, liberty, and property. Contemporary Supreme Court policy largely ignores this understanding with respect to the last item of this trilogy."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

through enforcing "rules of the game." Introducing greater competition in the federalist system, as in the case of "contracting-out," argues Bish, will help promote efficiency in government by reducing the potential for collusion and help preserve the foundations of constitutional democracy.

Bish therefore sees the major benefit of a federalist system in its ability to stimulate competitive pressures within government and to provide taxpayers with greater freedom of choice than if the national government had a monopoly on the provision of all public goods. In his opinion, political self-interest, like private self-interest, is best harnessed and directed toward the well-being of taxpayers and consumers by allowing open entry. It is only when property rights are not well-defined and private transactions costs are prohibitive that the competitive market process "fails" in promoting efficient resource usage. Bish, however, recognizes that government itself operates within a common property regime and that "federal systems do not generally produce as much price information as do private markets." The problem is to change the incentive structure within government in order to encourage behavior that is consistent with individual taxpayer/voter preferences. Federalism as a form of political competition helps serve this function.[14]

Bish also discusses fiscal federalism and suggests that it can be reconciled with the market-oriented political theory of federalism once it is recognized that the theory of public goods can be applied to governmental activities as well as functions. The main point of the paper, however, is quite simple: a better understanding of market economics, especially the role of competition, will improve our ability to reform the federalist system in a socially productive way.

Freedom and Fairness: A Constitutional Perspective

Richard Stroup examines the correspondence between freedom and fairness within an institutional setting characterized by private enterprise and constitutional democracy. He argues that individual freedom is best secured when the coercive power of government is limited to the protection of persons and property; and that fairness is best achieved under a stable government by law and a competitive

[14]In thinking of devices to increase efficiency within government, it is useful to pose the following question as formulated by Roland McKean (1972, p. 177): "What do these devices do to the property rights or appropriability of rewards—and therefore to the 'incentives'—of individual officials in government?" His answer is instructive: "If a device has little impact on appropriability, one should not expect dramatic impacts on behavior and decisions." See also McKean (1965) on the relationship between political competition and market competition.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

market process in which individuals are free to pursue their interests as long as they respect the equal rights of others. In particular, a free market system, in which individuals can capture the rewards of productive activities but bear the costs of unproductive activities, will spur economic growth as entrepreneurs search for new opportunities to engage in mutually beneficial exchange. In the process, lower-income households will benefit as well as higher-income households. Thus, if fairness is viewed both in terms of equality under the law and as an improvement in the well-being of lower-income households, a system of limited government and open markets, argues Stroup, can be viewed as both free and fair. Furthermore, experience shows that an economic system characterized by private property rights, freedom of contract, and widespread reliance on voluntary exchange is more likely to meet these criteria of fairness than a politically directed welfare state.

Stroup uses this line of argument, and the fact that government redistributive programs have often been directed more at those with political power than at lower-income households, to caution against overreliance on government transfers to help the poor. Indeed, he notes that massive welfare programs have not really helped the poor. The most successful weapon against poverty has been economic growth, not the tax and transfer programs that have characterized the welfare state. Thus, on grounds of both freedom and fairness, Stroup sees a system based on constitutional protection against direct and indirect takings outperforming the redistributive state.

The Public Trust and the Private Domain

The central question of a constitutional democracy is: What should be the split between the public and private domains? *Richard Epstein* addresses this question and presents a unified theory of property in his pathbreaking paper on the public trust doctrine. Having laid out an eminent domain theory of when it is justified to take private property for public use in his recent book *Takings: Private Property and the Power of Eminent Domain* (1985c), Epstein now proceeds to extend his analysis by resolving the problem of when it is justified to transfer public property to the private domain. In exploring these property rights issues, of course, Epstein is at the same time laying ground rules for state action: when the state can and cannot change the status quo; when it is legitimate to take private or public property and when it is not.

In his 1985 book, Epstein found that the vast majority of so-called regulatory takings have been illegitimate. He now establishes the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

conditions under which it would be illegitimate to move property from the public to the private domain. To resolve this problem of the public trust, Epstein discusses the rules of original acquisition and the rules of transfer. With respect to the latter, the principle of voluntary exchange is of crucial importance, since free trade implies mutual gains. Yet, multi-party transactions in the *public domain* require further scrutiny. With respect to the question of acquisition, Epstein argues that in the "original position" (prior to government), there will be some mix between unowned property and property held in common. To determine this mix, Epstein applies the following rule: "Property should be subject to that form of ownership that minimizes the bargaining problems associated with moving the asset to its highest-valued use." In most cases, this rule and that of first possession will lead to private ownership, but in other cases, for example, navigable waterways, the holdout problem and prohibitive private bargaining costs will exclude first possession and lead to common property ownership. Simply stated, Epstein's rule for determining the ownership mix in the original position is to "choose that form of ownership that minimizes the expected number of bargaining breakdowns."

On the question of privatization, Epstein views the public trust doctrine as the "mirror image" of the eminent domain clause and argues, "No *public* property may be transferred to *private use*, without just compensation." The compensation test is necessary to help ensure that such transfers will move public property to higher-valued uses. To minimize the chance of a mistaken transfer, Epstein recommends public hearings and competitive auctions; and the compensation must be "payable to the public at large."

In searching for a constitutional basis for the public trust doctrine, Epstein points to Justice Field's elusive opinion in *Illinois Central Railroad v. Illinois* (146 U.S. 387 [1892]). He notes that although Justice Field's decision to rule against the railroad and in favor of the state's right to retain title to the lakebed (as common property) was consistent with his overall support of private rights and markets, his logic should have turned on the facts of the case—and he should have dealt more thoroughly with the question of just compensation for the transfer of property from public to private use. If a "constitutional home" is to be found for the public trust doctrine, argues Epstein, the two most likely candidates are the due process clause and the equal protection clause of the Fourteenth Amendment. Much work, however, remains to be done in order to secure a sound constitutional footing for the public trust doctrine.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

When Epstein relaxes his assumption that state-held property was acquired in the original position and takes up cases where the state acquired property by purchase or condemnation, the implication is that there is a limit on the ability of state officials to give exclusive franchises to such property. For example, if the land used for a public highway was obtained via purchase or condemnation, it is doubtful if the state can then legitimately restrict access to the highway for the purpose of commercial transportation by issuing licenses on a selective basis, contends Epstein. The upshot of Epstein's unified theory of property is that the eminent domain clause and the public trust doctrine both operate to limit government power over a wide range of activities, regardless of the original distribution of resources between private and public property.

Constitutional Economics and Constitutional Reform

Rutledge Vining (1956, pp. 20–21) has emphasized that technical economics is narrowly concerned with "problems of choice in which ends are well-defined," but that the more policy-relevant problem is "the problem confronting a community of individuals who are jointly making a choice of conditions which they will mutually impose as constraints upon their individual actions." In Vining's opinion, the tools of modern technical economics must be carefully applied at the level of constitutional economics, that is, within the realm of political economy addressing the broad problem of social and economic organization. Buchanan and Tullock would no doubt agree. Indeed, it was their dissatisfaction with conventional economics and their desire to redirect attention to the important problems of political economy that helped motivate the *Calculus* and led to the study of public choice and constitutional economics.

With the growth of government and the erosion of economic rights over the past half century, it is of critical importance to move toward a constitutional economics, which incorporates the insights of classical political economy in studying the state and the market.[15] Unless individuals understand the institutional foundations of the competitive market system, especially the importance of constitutional protections for economic liberties in promoting overall freedom and wealth, those institutions are likely to be further eroded.

The deference of the Supreme Court to legislative activism in the area of economic rights has helped produce the modern welfare state, along with the maze of administrative rules and regulations that have

[15]For an in-depth treatment of the subject of constitutional economics, see McKenzie (1984) and Gwartney and Wagner (1988).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

undermined private property rights and freedom of contract. As a result, the rent-seeking motive has come to dominate the profit motive as individuals vie for the economic empowerments of government. Predation, not wealth creation, is the hallmark of much of what passes for economic legislation. In Buchanan's words (1977, p. 296): "The present situation in the United States" is "one of 'constitutional anarchy.' The effective constitution has been allowed to erode to the extent that the predictability that should be inherent in a legal structure is seriously threatened."

Buchanan attributes the demise of limited government to the piecemeal approach to policymaking—"adjustments made to situations as they are confronted without attention to the design of the structure as a whole"—and to "intellectual error of monumental proportions" that "has destroyed our understanding of 'the constitution of freedom,' an understanding that the American founding fathers did possess" (p. 296). The current sympathy for protectionism, the lack of any effective constraints on the taxing and borrowing powers of government or on its monetary authority, the circumvention of the commerce clause, the failure of the judiciary to declare legislative takings—both direct and indirect—unconstitutional when they occur outside the strict limits of the Fifth and Fourteenth Amendments, and numerous other violations of the Framers' constitutional provisions for protecting economic rights, either explicitly stated in the document or inherent in the higher-law background, illustrate the extent to which both substantive and procedural constraints on governmental economic power have been attenuated.

The erosion of the Framers' "economic constitution" has proceeded slowly but surely. Nevertheless, the time may be ripe for what Buchanan (p. 297) has called "genuine constitutional revolution." Such a revolution, which would restore the "constitution of freedom," will require taking on a "constitutional attitude," by which Buchanan means "an appreciation and understanding of the difference between choosing basic rules and acting within those rules" (p. 298). There will be a "public-goods problem" to overcome in organizing meaningful constitutional change, says Buchanan, but just as the political economy of Adam Smith and the constitutional economics of the Framers' were instrumental in bringing about reform in England and America, it may again be possible to renew the "constitutional attitude" and restore the vision of the Founding Fathers for a free and prosperous people.[16]

[16]Buchanan (1977, pp. 298–99), in addressing the "public-goods problem," raises a number of interesting questions regarding the organization and implementation of real

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

By taking a public choice/constitutional perspective, the essays in this volume direct attention to the fundamental issues of political economy, those of social coordination and protection of individual rights—issues central to the American Revolution and the framing of the original Constitution and Bill of Rights. As such, they will contribute to the emerging field of constitutional economics and help pave the way for authentic constitutional reform.

References

Arrow, Kenneth J. *Social Choice and Individual Values*. New York: Wiley, 1951.

Black, Duncan. *Theory of Committees and Elections*. Cambridge: Cambridge University Press, 1958.

Buchanan, James M. *Freedom in Constitutional Contract: Perspectives of a Political Economist*. College Station: Texas A & M University Press, 1977.

Buchanan, James M. "The Public Choice Perspective." *Economia delle scelte pubbliche* 1 (January 1983): 7–15.

Buchanan, James M. "The Constitution of Economic Policy." *American Economic* Review 77 (June 1987): 243–50.

Buchanan, James M., and Tullock, Gordon. *The Calculus of Consent: Logical Foundations of Constitutional Democracy*. Ann Arbor: University of Michigan Press, 1962.

Dorn, James A. "The Transfer Society." Introduction. *Cato Journal* 6 (Spring/Summer 1986): 1–17.

Dorn, James A. "Judicial Protection of Economic Liberties." In *Economic Liberties and the Judiciary*, pp. 1–28. Edited by James A. Dorn and Henry G. Manne. Fairfax, Va.: George Mason University Press, 1987.

Dorn, James A. "Public Choice and the Constitution: A Madisonian Perspective." In Gwartney and Wagner (1988, pp. 57–102).

Downs, Anthony. *An Economic Theory of Democracy*. New York: Harper, 1957.

Epstein, Richard A. "Asleep at the Constitutional Switch." *Wall Street Journal*, 9 August 1984, p. 28.

Epstein, Richard A. "Needed: Activist Judges for Economic Rights." *Wall Street Journal*, 14 November 1985a, p. 32.

Epstein, Richard A. "Judicial Review: Reckoning on Two Kinds of Error." *Cato Journal* 4 (Winter 1985b): 711–18.

Epstein, Richard A. *Takings: Private Property and the Power of Eminent Domain*. Cambridge, Mass.: Harvard University Press, 1985c.

Gwartney, James D., and Wagner, Richard E., eds. *Public Choice and Constitutional Economics*. Greenwich, Conn.: JAI Press, 1988, forthcoming.

constitutional change, which need further study. Although he recognizes the difficulty of reform, he points to the experience of 18th-century England and America as evidence that future constitutional revolution is possible, especially in light of the current dissatisfaction with "big government."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Hayek, Friedrich A. "The Use of Knowledge in Society." *American Economic Review* 35 (September 1945): 519–30.

Hayek, Friedrich A. "The Meaning of Competition." 1946. In *Individualism and Economic Order*, pp. 92–106. South Bend, Ind.: Gateway Editions, 1948.

Hayek, Friedrich A. "Competition as a Discovery Procedure." 1968. In *New Studies in Philosophy, Politics, Economics and the History of Ideas*, pp. 179–90. Chicago: University of Chicago Press, 1978.

Hayek, Friedrich A. *The Constitution of Liberty*. Chicago: University of Chicago Press, 1960.

Macedo, Stephen. *The New Right v. The Constitution*. Washington, D.C.: Cato Institute, 1986.

Madison, James. Speech in First Congress. 9 April 1789. In Padover (1953, pp. 269–70).

McKean, Roland N. "The Unseen Hand in Government." *American Economic Review* 55 (June 1965): 496–505.

McKean, Roland N. "Property Rights within Government, and Devices to Increase Governmental Efficiency." *Southern Economic Journal* 39 (October 1972): 177–86.

McKenzie, Richard B., ed. *Constitutional Economics: Constraining the Economic Powers of Government*. Lexington, Mass.: Lexington Books, D. C. Heath and Co., 1984.

Niskanen, William A. "A 'Constitutional' Perspective on Social Welfare Policy." Paper presented at the Ford Foundation Conference on Social Welfare Policy and the American Future, Racine, Wis., 3–5 November 1985.

Niskanen, William A. "The Erosion of the Economic Constitution." Foreword. In Gwartney and Wagner (1988a, pp. xi–xiii).

Niskanen, William A. Letter to the Honorable James Miller. 6 January 1988b.

Padover, Saul K., ed. *The Complete Madison: His Basic Writings*. New York: Harper, 1953.

Pilon, Roger. "On the Foundations of Justice." *The Intercollegiate Review* 17 (Fall/Winter 1981): 3–14.

Pilon, Roger. "Legislative Activism, Judicial Activism, and the Decline of Private Sovereignty." *Cato Journal* 4 (Winter 1985): 813–33.

Rawls, John. *A Theory of Justice*. Cambridge, Mass.: Harvard University Press, 1971.

Rutland, Robert A. *James Madison: The Founding Father*. New York: Macmillan, 1987.

Siegan, Bernard H. *Economic Liberties and the Constitution*. Chicago: University of Chicago Press, 1980.

Siegan, Bernard H. "The Supreme Court: The Final Abiter." In *Beyond the Status Quo: Policy Proposals for America*, pp. 273–90. Edited by David Boaz and Edward H. Crane. Washington, D.C.: Cato Institute, 1985.

Vining, Rutledge. *Economics in the United States of America: A Review and Interpretation of Research*. Paris: United Nations Educational, Scientific and Cultural Organization, 1956.

Wicksell, Knut. "A New Principle of Just Taxation." 1896. In *Classics in the Theory of Public Finance*, pp. 72–118. Edited by Richard A. Musgrave and Alan T. Peacock. New York: St. Martin's Press, 1958.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

JUSTIFICATION OF THE COMPOUND REPUBLIC: THE *CALCULUS* IN RETROSPECT

James M. Buchanan

Elsewhere I have stated that the public choice perspective combines two distinct elements: the extension of the economist's model of utility-maximizing behavior to political choice and the conceptualization of "politics as exchange" (Buchanan 1983). The *Calculus of Consent* (1962) was the first book that integrated these two elements into a coherent, logical structure. It will be useful here to compare and contrast the argument developed in the *Calculus* to those that were present in the nascent public choice analysis of the time as well as in the then-conventional wisdom in political science.

The Model of Utility Maximization

Kenneth Arrow published his seminal *Social Choice and Individual Values* in 1951; Duncan Black's *Theory of Committees and Elections* appeared in 1958, following earlier papers published in the late 1940s and early 1950s; and Anthony Downs published *An Economic Theory of Democracy* in 1957. These three writers were all economists, as was Joseph Schumpeter whose *Capitalism, Socialism, and Democracy* (1942) contained precursory, if widely neglected, parallels to the inquiries that followed. In each case, analysis was grounded on the economist's model of utility maximization. Indeed, in the Arrow, Black, and later social choice constructions, the individual is viewed as ranking his preferences over alternative social states. Downs's work differs from the social choice strand of inquiry in that he modeled the behavior of political parties analogously to that of profit-seeking firms in a competitive market environment; but ultimately, the construction is also based on the utility-maximizing

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.

The author is Director of the Center for Study of Public Choice and University Professor at George Mason University. He is the recipient of the 1986 Nobel Prize in Economics.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

behavior of office-seeking politicians and interest-seeking voting constituents.

The missing element in these constructions is any justificatory argument for democratic process that embodies individualistic norms for evaluation. Arrow and Black seemed to place stability and consistency in "social choice" above any consideration of the desirability of correspondence between individual values and collective outcomes. Downs seemed to be interested in the predictions of the results of majoritarian political processes independently of overriding the desires of persons in minority preference positions. Arrow dramatically proved that consistent sets of individual orderings need not generate consistent social or collective results under any rule; but he totally neglected any normative reference to the possible coercion of minority preferences or interests in any non-unanimous rule structure.[1]

The Justificatory Basis for Collective Action

These works left us with a dangling question: Why should an individual enter into a collective? The authors of these works presumed, without inquiry, that the individual was locked into membership in a political community and that the range and scope of the collective's activities were beyond the control of the individual and, by inference, beyond the boundaries of analysis amenable to any individualistic calculus. The *Calculus* differed from the precursory works in one fundamental respect, namely, it embodied *justificatory* argument. The *Calculus* sought to outline, at least in very general terms, the conditions that must be present for the individual to find it advantageous to enter into a political entity with constitutionally delineated ranges of activity or to acquiesce in membership in a historically existent polity.

The intellectual-analytical vacuum was much more apparent in relation to the early extensions of economic methodology to the political process than it seemed in then-conventional political science inquiry. Precisely because Black, Arrow, and Downs explicitly incorporated individual utility maximization in their analyses, possible differences among persons in preference orderings over political alternatives emerged as a central issue. In a model with identical preferences, the problems addressed by Arrow, Black, and Downs do not directly arise. Once preferences over political choice options

[1]Arrow's emphasis on stability and consistency in *collective* results to the neglect of *individual* interests was the primary target of my own criticism (Buchanan 1954).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

are presumed to differ, however, it is but a natural extension to consider the choice among political regimes.

Normative political science in the 1950s offered a dramatically different ideational environment. Influenced in part by Hegelian-inspired idealism, the interest of the individual was treated as being embodied in the state and in politics as process. Even for many of those who could scarcely be classified as falling within the Hegelian tradition, politics was still conceived as a search for truth and goodness, a search from which a uniquely determinate "best" result (for *everyone*) emerges. One important strand of positive political analysis, based largely on the work of Arthur Bentley ([1908] 1935), focused on conflicts among differing interests but in turn tended to neglect the cooperative elements that are necessary to justify playing the game at all.

If we remain within the presuppositions of methodological individualism, the state or the polity must ultimately be justified in terms of its potential for satisfying individuals' desires, whatever these might be. The state is necessarily an artifact, an instrument that has evolved or is designed for the purpose of meeting individual needs that cannot be readily satisfied under alternative arrangements. In this sense, the great game of politics must be a positive-sum game. If this fact is recognized while also acknowledging the potential for conflict among differing individual interests, the basic exchange model of the economist is immediately suggested. In this elementary model, traders enter the interaction process with distributionally conflicting interests but in a setting that offers mutuality of gain from cooperation.

Wicksell's Unanimity Criterion

This second element in the inclusive public choice perspective, that of "politics as exchange," is necessary to make any justificatory argument. In adding this element to the utility-maximizing models for individual choice behavior in politics, Gordon Tullock and I were directly influenced by the great work of Knut Wicksell (1896), the primary precursor of my own efforts in public choice and in political economy generally. Along with a few of his European colleagues, Wicksell sought to extend the range of economic analysis of resource use to the public or governmental sector. He sought a criterion for efficiency in the state or collective use of resources that was comparable to the criterion that had been formally specified for the use of resources in the market sector of the economy. In determining the value of the collective use of a resource, Wicksell adhered to the basic individualistic postulate of market exchange: individuals, who

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

both enjoy the benefits of state-financed services and pay the costs in sacrificed privately supplied goods, are the only legitimate judge of their own well-being. From this individualistic presupposition, there emerged the Wicksellian unanimity criterion—if any proposed public or governmental outlay is valued more highly than the alternative market or private product of the resources, there must exist a tax-sharing scheme that all citizens will agree upon. If there is no tax-sharing scheme that will secure unanimous approval, the proposed outlay fails the test. Note that this basic Wicksellian proposition incorporates the epistemological humility of revealed preference as well as the Pareto criterion for evaluation, both of which emerged as independently developed ideas later.

In proposing a departure from the established majority voting rule in legislative assemblies, Wisksell was suggesting a change in the effective political constitution, the set of constraints within which political choices are made. He shifted the ground for discourse. Rather than discuss the relative efficiency of policy options under an unchanging rules structure, with little or no regard given either to what efficiency means or for any prospect for the desired option being chosen, Wicksell sought to open up the structure of decision rules as a variable that might be chosen instrumentally for the purpose of ensuring that collective action meet a meaningfully defined efficiency norm. Wicksell, of course, recognized that the strict requirement for unanimity would offer incentives for strategic behavior to all participants and that some relaxation of this requirement might be necessary for practicable operation. By reducing the requirement to, say, five-sixths of the voting members of the assembly, the incentives for strategic behavior are dramatically reduced and there is insurance against most, if not all, inefficient outlay.

Wicksell, however, did not move beyond the development of criteria for evaluating policy alternatives one at a time. He shifted attention to a change in the decision rules, from simple majority voting toward unanimity, to ensure against collective approval of projects that do not yield benefits equal to or in excess of costs, *on any ordinary project.*[2] Wicksell did not extend his analysis to the operation of specific decision rules over a whole sequence of time periods or separate categories of outlay, which might have allowed for less restrictive criteria for single projects.

[2]Wicksell exempted categories of outlay that were considered to be irrevocable commitments, for example, interest on public debt.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Extension of the Wicksellian Criterion to Constitutional Choice

In the *Calculus,* Tullock and I made this extension. We were directly influenced by discussions with our colleague Rutledge Vining at the University of Virginia, who hammered home the argument that political choices are among alternative rules, institutions, and arrangements which generate patterns of results that are at least partly stochastic. We should then evaluate the working of any rule not in terms of its results in a particularized choice situation, but in terms of its results over a whole sequence of separate "plays," separated both intercategorically and intertemporally. Vining's insistence on the relevance of the analogy with the selection of the rules for ordinary games was part of the intellectual environment in Charlottesville, and the shift of the Wicksellian criterion from single projects to rules seemed a "natural" one for us to take.

In the confined Wicksellian choice setting, an individual, behaving non-strategically, will vote to approve a proposed collective outlay if he anticipates that the benefits he secures will exceed the tax costs. He will oppose all proposals that fail this test. If, however, the individual is placed in a genuine *consitutional* choice setting, where the alternatives are differing decision rules under which a whole sequence of particular proposals will be considered, he will evaluate the predicted working properties of rules over the whole anticipated sequence. If, on balance, the operation of a defined rule is expected to yield net benefits over the sequence, the individual may vote to approve the rule, even if he predicts that he must personally be subjected to loss or damage in some particular "plays" of the political game.

By shifting the applicability of the unanimity or consensus criterion from the level of particular proposals to the level of rules—to constitutional rather than post-constitutional or in-period choices—we were able to allow for the possibility that preferred and agreed-on decision rules might embody sizable departures from the unanimity limit, including simple majority voting in some cases and even less than majority voting in others. The constitutional calculus suggests that both the costs of reaching decisions under different rules and the importance of the decisions are relevant. And because both of these elements vary, the preferred rule will not be uniform over all ranges of potential political action.

The construction seemed to offer justificatory argument for something akin to the complex political structure that James Madison had in mind, much of which finds itself embedded in the constitutional framework approved by the Founding Fathers. There is a justification

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

for the compound republic, for constitutional democracy, that can be grounded in individual utility maximization; but the general argument does not allow the elevation of majority rule to dominating status. This rule, whether in the entire electorate or in the legislative assembly, takes its place alongside other rules, some of which may be more and others less inclusive.

At the constitutional stage of choice among rules, our argument conceptually requires unanimous agreement among all parties. In this sense, we were simply advancing the Wicksell-Pareto criterion one stage upward in the choice-making hierarchy. As we suggested, however, agreement on rules is much more likely to emerge than agreement on policy alternatives within rules, because of the difficulties in identifying precisely the individual's economic interests in the first setting. The rule to be chosen is expected to remain in existence over a whole sequence of time periods and possibly over a wide set of separate in-period choices. How can the individual at the stage of trying to select among rules identify his own narrowly defined self-interest? How can he predict which rule will maximize his own net wealth? He is necessarily forced to choose from behind a dark "veil of uncertainty." In such a situation, utility maximization dictates that generalized criteria, such as fairness, equity, or justice, enter the calculus rather than the more specific arguments, such as net income or wealth.

This construction enabled us analytically to bridge, at least in part, the gap between narrowly defined individual self-interest and an individually generated definition of what could be called the general interest. In this construction, our efforts were quite close to those of John Rawls, which culminated in his seminal book, *A Theory of Justice* (1971). Early papers published in the late 1950s had adumbrated the essential parts of the Rawlsian construction; and while our own construction was independently developed, we were familiar with Rawls's parallel efforts.[3]

Our analysis differed from that of Rawls, however, in the important respect that we made no attempt to generate specific predictions as to what might emerge from the prospective agreement among the contractors who choose rules from behind the veil of uncertainty. Our construction suggested that no single decision rule was likely to be chosen for general applicability over the whole range of political action. We used the construction to eliminate some sets of outcomes rather than to specify those sets that would be selected. By contrast,

[3]We were not familiar at all with the construction of John Harsanyi, which had appeared in the mid-1950s, but with quite a different normative purpose.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Rawls was led (we think, misled) to attempt to use the veil-of-ignorance construction to make specific predictions. He suggested that his two principles of justice would uniquely emerge from the preconstitutional stage of contractual agreement.

The Social Contract Tradition

When constitutional-stage politics is conceptualized as exchange among utility-maximizing individuals, we are obliged to classify ourselves as working within the social contract tradition in political philosophy. Precursors of the *Calculus* are found in the works of the classical social contract theorists rather than in the works of the idealists or the realists. What has been and remains surprising to me has been the reluctance or inability of social scientists, philosophers, and especially economists to understand and appreciate the relationships between the institutions of voluntary exchange, the choice among constitutional rules, and the operations of ordinary politics within such rules. James Madison clearly had such an understanding, which we tried to articulate in modern analytical language a quarter-century ago. There has been some shift toward recovery of the Madisonian wisdom in both public and scholarly attitudes over two and one-half decades. Perhaps the *Calculus* contributed marginally to this change. But both "politics as pure conflict" and "politics as the quest for truth and light" continue as dominant models shaping both public and "scientific" views on collective action.

References

Arrow, Kenneth J. *Social Choice and Individual Values*. New York: Wiley, 1951.

Bentley, Arthur. *The Process of Government*. 1908, Reprint. Bloomington: Principia Press, 1935.

Black, Duncan. *Theory of Committees and Elections*. Cambridge: Cambridge University Press, 1958.

Buchanan, James M. "Social Choice, Democracy, and Free Markets." *Journal of Political Economy* 62 (April 1954):114–23.

Buchanan, James M., and Tullock, Gordon. *The Calculus of Consent*. Ann Arbor: University of Michigan Press, 1962.

Buchanan, James M. "The Public Choice Perspective." *Economia delle scelte publiche* 1 (January 1983):7–15.

Downs, Anthony. *An Economic Theory of Democracy*. New York: Harper, 1957.

Harsanyi, John. "Cardinal Welfare, Individualistic Ethics, and Interpersonal Comparisons of Utility." *Journal of Political Economy* 63 (August 1955):309–21.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Rawls, John. *A Theory of Justice*. Cambridge: Harvard University Press, 1971.
Schumpeter, Joseph. *Capitalism, Socialism, and Democracy*. New York: Harper and Row, 1942.
Wicksell, Knut. *Finanztheoretische Untersuchungen*. Jena: Fischer, 1896.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE *CALCULUS*: POSTSCRIPT AFTER 25 YEARS

Gordon Tullock

The Neglect of Constitutional Theory and Reform

Before I arrived at the University of Virginia to begin my postdoctoral fellowship, I had had only the slightest of personal contacts with Jim Buchanan. My formal background was not in economics and, indeed, I did not favor welfare economics. Buchanan rather quickly converted me, but I have always been unhappy with the Paretian apparatus. Although I have attempted to invent improvements or replacements for that apparatus, I cannot say that I have been entirely successful.

Because of my background, Buchanan and I had a different approach to our joint work. Specifically, my goal was to understand the government and, if possible, improve its functioning. For me, using economic tools was a way of reaching this larger goal rather than an end in itself. My interest in political exchange was only instrumental. All of this provided a genuine but not large difference in approach. The mild amount of tension between our approaches together with the similarity of our basic perspective contributed to the success of the analysis.

Unlike Buchanan, however, I have been disappointed by the subsequent history of *The Calculus of Consent*. Although it has sold well, been used in classes, and has affected the thinking of many people, there has been almost no further research along the same lines. This is not to say that research in public choice theory has not flourished, but Duncan Black's "median preference theorem" and Anthony Downs's work on information in politics have led to much more research and elaboration than the constitutional perspective of the *Calculus*. Also, my later discovery of rent-seeking (Tullock 1967)

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.

The author is Karl Eller Professor of Economics and Political Science at the University of Arizona.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

prompted more articles that directly attempted to apply and expand on the logic of the constitutional perspective than did the *Calculus* itself. The same could be said of Buchanan's "An Economic Theory of Clubs" (1965).

I am not claiming that no one has done any research based on the *Calculus* nor that the "simple constitutional perspective" has not had great influence.[1] But the more elaborate constitutional theory of the book has stimulated almost no research. There has been substantially no work on constitutions per se.

For example, in a recent series of papers Kenneth Shepsle and Barry Weingast (see esp. 1984) attempted to explain the functioning of the House of Representatives in terms of semiconstitutional procedural rules that the House has adopted. These rules, however, are not part of the Constitution, and the authors never really take a reformist perspective. Indeed, they seem to think that these rules are acceptable, even though they do not formally endorse them and do not suggest any improvements. Further, Shepsle and Weingast do not compare the semiconstitutional rules with the rules used by other governmental bodies such as the British legislature. From the time of the first reform act to about 1890, the British legislature used an institutional structure that was completely different from the one the authors describe (incorrectly I think) for the House of Representatives, but as far as I know, neither the authors nor modern public choice scholars have looked into the difference and attempted a comparative evaluation. The real importance of such an evaluation could be as a first step toward developing improved constitutional rules.

In undertaking comparative constitutional studies, a comparison of the Swiss and U.S. constitutions would be a useful starting point. The Swiss constitution is the strongest modern competitor with the U.S. Constitution in terms of promoting stable government by law and a prosperous economy. Although Switzerland has a concentration of public choice scholars, they have done very little work on the differences between the two constitutions. Such studies, with efforts to evaluate performance, would be particularly useful because the 1848 Swiss constitution, which was modeled on the American constitution, has many similarities and certain radical differences. Some Swiss researchers have looked into the impact of using public referenda in Switzerland, but this research is still in its infancy and has

[1]The "simple constitutional perspective," which Buchanan and I introduced in the *Calculus*, consists of explaining the behavior of government by looking at its basic institutions rather than its specific activities.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

yielded no conclusive policy proposals either for Switzerland or the United States.

To consider a less significant gap, the German constitution provides for electing a lower legislative house, a compromise between the single-member constituency and proportional representation. So far as I know, no public choice scholar has analyzed its working. This is particularly impressive because the system appears to give considerably more political weight to people whose first preference is a minor party (provided it has at least 5 percent of the electorate) than to those who favor one of the two major parties.[2]

The absence of any reformist drive in the constitutional area is especially noteworthy because the *Calculus* was a reformist book. Perhaps its strongest single implicit recommendation for reform was the switch from simple majority to a reinforced majority in the legislature. In the early days, conventional political scientists regularly denounced us for this proposal. There was even some research that purported to demonstrate that a simple majority was optimal. Today, people are still critical, but they just do not talk about the issue any more.

As the author of the chapter in the book on bicameral legislatures (Chap. 16), I find it notable that it too has had no discernible effect on researchers. In essence, I argued for bicameral legislatures on efficiency grounds and urged that the two houses be elected by radically different methods. Not only has this idea vanished into the memory hole, but the actual trend has been in the opposite direction. The Supreme Court, for example, decided some years after the Constitution had been ratified that although it was all right for the federal government to have a senate that was not elected according to population, it was undemocratic for anyone else to do it. In so doing, they sharply reduced the efficiency of the state legislatures without anybody, except myself, realizing that they had done so.[3] The decision was criticized because it was a pretty cloth-headed thing to do from a constitutional standpoint, but no one mentioned that it would lower efficiency.

As a particularly extreme example, most European Public Choice Society members live in societies that have proportional representation. I prefer this system, but I would really like to see a two-chamber legislature, with one chamber elected by single-member

[2]This is my own deduction and assumes that voters behave strategically. Since I do not read German, the possibility of error is sizable.

[3]The Swedes recently abolished one of their two houses. This was succeeded by rapid governmental growth, which should have astonished no one who had read the *Calculus*.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

constituencies and the other by proportional representation.[4] I expected to see a good deal of work comparing the two systems, but it does not yet exist.

But that is not all I had hoped for. There was also opportunity for a good deal of reformist activity in the sense that public choice scholars would propose new and improved ideas for government at the constitutional level and make some efforts to popularize them. The prospect of a few scholars getting a constitutional amendment adopted was unlikely, but we should have begun even if we anticipated no real effects for many years. Keynes's remarks about the role of ideas may be exaggerated, but they are not fundamentally wrong. New ideas invented in the quiet studies of scholars sometimes do change the world.

While I appear to be criticizing the development of constitutional theory since the publication of the *Calculus*, the criticism applies to my own work as well as to others'. I have devoted a good deal of attention to attempting to improve our knowledge of constitutions and somewhat less to propagandizing what we know, but I have been unsuccessful on both fronts.

It may be, then, that the basic reason we have not progressed along the lines I have outlined is that it is very difficult. Certainly I have found it to be hard. But even if the basic reason for the neglect of constitutional theory and reform is very simple, I am not prevented from being disappointed. Given my age, I am decidedly disappointed at the failure of medicine to do very much on "life extension." But I do not blame the doctors for the failure. What I am saying here is that I am disappointed with the lack of development of the ideas in the *Calculus*, but I do not blame anybody for it. I certainly do not feel that I should have devoted more effort to developing our knowledge of public choice and pressing constitutional reforms. As a matter of fact, I have done more research than my publications in this area indicate—a case of a lot of work and little result.

I am inclined to view the *Calculus* as a sport. In all fields of science, an occasional discovery is ahead of its time due to essentially accidental factors. There is apt to be little progress in that field until the rest of science has caught up with it. Steam engines, first built in Alexandria 2,000 years ago, are an example. I hope that the theory of constitutions will be caught up in a general advance with less delay.

[4]Japan actually has something that is a distant relative of this preferred system. I would like to have some Japanese members of the Public Choice Society look into it and decide if it may be one of the reasons they have been so successful.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Problem of Self-Enforcing Constitutions

Having noted my disappointment with the absence of progress in the constitutional theory and in the reformist application of what we know, I would also say that I am unhappy with the particular reforms that are normally pressed. As originally drawn up in Philadelphia, the Constitution has built into it a short Bill of Rights. Madison was personally opposed to adding the first 10 amendments, which he was forced to sponsor for political reasons. He preferred a government so structured that it was unlikely to trample on liberty rather than devising specific restrictions on that government.

I think Madison's position is the correct one. The view that the government can be bound by specific provisions is naive. Something must enforce those provisions, and whatever it is that enforces them is itself unbound. We have a particularly strong example of this in the history of the Supreme Court since about 1950. The comparative freedom and efficiency with which Americans were governed in the first century and a half of the Constitution depended on the structural characteristics of the Constitution, not on the Bill of Rights.

This raises the basic problem of what I call the "self-enforcing constitution." Granted that we have invented a good constitution, how do we make sure that it will work the way we have written it. The history of the United States shows many deviations from the Founders' vision. The most conspicuous one today is the Supreme Court's arrogation to itself of vastly more power than the Framers intended. How could the constitutional designers have prevented this from happening?

It used to be said that enforcing the Constitution was simple; we could leave it to the Supreme Court. The Framers relied on the amendment process as a way of changing the Constitution in the event that it became out-of-step with the times. In a way, the amendment process was the cause of the Civil War. In *Dred Scott,* Justice Taney had correctly interpreted the Constitution as it was originally written. The problem for the Southern states was the high probability that a Republican abolitionist president would prevent slavery's spread to the West. The Republicans would then admit enough Western states without slavery to permit an amendment abolishing slavery.[5]

The current situation is different. A great many people, including many law professors and at least one Supreme Court justice, argue

[5]It is frequently argued that the actual cause of the Civil War was not slavery, but the economic difference between the manufacturing North and the agricultural South. The problem with this argument is that the Republican party essentially started in the agricultural West.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

that it is the duty of the Supreme Court to impose on the people the Constitution as they think it should be, not the Constitution as it was written. In this view, changes in the Constitution are to take place not through the amendment process, but through a change in the views of nine old men. There is, of course, a theory of government advocating that we should be ruled by "the best" instead of by the voter. I do not wish to argue here the merits of that point of view, only that it clearly is not what the Founding Fathers had in mind.

If we design a new constitution, is there some way to guarantee that it will function according to design? For example, during the period of time in which the states were ratifying a constitutional amendment providing that everyone over the age of 18 could vote, the Supreme Court suddenly decided that the Constitution already provided for it. This problem of the self-enforcing constitution has so far evaded solution. The Founding Fathers set up a constitution that remained more or less unchanged for a long time. Indeed, it was not until this century that significant changes were made in the original design.

Changes in the Effective Constitution

There does not appear to be any obvious explanation for this long period of stability, but I believe it was the result of a very strong internal conflict having been built into the Constitution. During the 19th century, for example, the Senate usually rejected treaties negotiated by the executive. This was not a government that could impose its will strongly on any objecting group. Thus, it was generally unable to expand its power, and the states remained the dominant governments in the United States. Due to internal free trade, the states were unable to carry out much in the way of rent-seeking, although they certainly tried.

In my opinion, the basic change occurred because of a quasi-constitutional revision in the terms of employment of the federal bureaucracy. The gradual extension of the Civil Service Act throughout the government from the 1890s to the time of World War I politically changed the balance-of-power within government. This is one of the many cases in which the reform movement at the turn of the century went badly astray. In this case, there was a mix of well-intentioned, well-educated people who did not actually understand either the government or a special interest. In this case, the special interest was composed of existing government employees. The Civil Service System provided examinations for new employees (mainly on irrelevant subjects); but each time the exams were changed or the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

system was extended, the existing employees were grandfathered in. The change from a situation where employees were completely subject to their political superiors to one where they could not be easily fired was a great step forward for civil servants.[6]

The results differed from those that the well-intentioned progressives probably intended. Civil servants ceased being dependent on their political superiors, who in turn were dependent on the voters. Further, politicians became partially dependent on the civil servants. They could no longer fire civil servants, but as voters the civil servants might fire the politicians. As a consequence, the politicians became partisans of their nominal employees, and civil servants became an extremely powerful special interest group.

In the early days, this new power had almost no effect on civil servants' job performance, but it did have a great effect on their political activities. The spoilsmen would have been political appointees of whatever political administration happened to be in office at the time. They would probably continue to support that party after they were grandfathered into the civil service, but they were no longer dominated by the politicians because careers were safe. At first, they found it desirable to contribute to political parties and otherwise work for them in order to protect their prospects for promotion. Indeed, it seems likely that the legal restrictions on employees engaging in political activity were largely pushed by the civil servants themselves because it prohibited this unpleasant duty.

Over time the number of civil servants increased. One explanation for this was the political power held by the civil servants, whose "unions" devoted themselves to lobbying rather than to threatening strikes.[7] This may be what has led to the somewhat odd structure of pay of what is now the government's largest single organization. In general, the lower ranking civil servants are overpaid and the people at the top are underpaid. Indeed, Congress has periodically put upper limits on salaries with the result that promotion in the upper ranks does not increase wages. The reason for this restriction is clearly that there are a lot of votes in the lower ranks and very few in the upper ranks.

Thus, I believe that the Civil Service Act was perhaps the largest single change in our "effective constitution" before the efflorescence of the Supreme Court in the 1950s. In a way, the two events are

[6]The reformers who attempted to improve the medical profession by once again grandfathering all existing doctors in and providing examinations for new entrants also greatly benefited existing members of the profession.

[7]The postal workers do both.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

coterminus, because the Supreme Court does not seem to have many differences with the Civil Service. In both cases, there has been a sharp aggrandisement of the power of the federal government and a sharp reduction in the power of the states. One way of approaching a study of this matter would be to examine cross-nationally the growth of government and the expansion of the Civil Service.

The Desirability of Comparative Constitutional Study

This brings me back to the desirability of comparing other constitutions. The Founding Fathers did make some comparisons, although the information they had available was quite limited. They knew only about the Athenian Republic, the Roman Republic, their own state governments, and the English government from which they had just revolted.[8] Even though they had this knowledge, it seems likely that the basic structure that we now regard as efficient was accidental. The basic decentralization of the Constitution, that is, the reservation of most governmental activities to the states, came from the very simple straightforward fact that the states already existed and it was necessary to persuade them to voluntarily join the new federal government. The states were unlikely to voluntarily dissolve themselves in order to form a centralized state, although it is quite probable that Hamilton would have been happy with that result.

The diversely selected bicameral legislature was another compromise between the large states that wanted a population-based representation and the small states that wanted each state to be equally represented. It may have been important that a number of the state legislatures already had two chambers.[9] There were not only two houses, but they were also elected by different methods (which, if you accept the argument in the *Calculus*, was an efficiency characteristic). Dividing the government into executive, legislative, and judicial branches was an imitation of English government structure by way of Montesquieu.

The method of electing the President, making that office in many ways a third house of the legislature, is a particularly clear case of accidental constitutional provision. The system never worked in the

[8]Many of them seemed to have learned of the English government through Montesquieu, and it has sometimes been said that the American Constitution is a misunderstanding of Montesquieu's misunderstanding of the British constitution.

[9]In a number of cases the upper chamber was part of the executive branch. For example, in Virginia under the old colonial charter, it functioned rather like England's House of Lords.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

way it was originally intended to, and the Constitution was amended to change the process after the 1800 presidential election. It seems likely that those who fashioned this provision of the Constitution intended that the most popular politician in the United States would be President and the second most popular to be Vice-President. If so, their draftsmanship was extremely defective.[10] It is interesting to speculate on what would have happened if the probable intent of this provision had been implemented. It is possible that the two-party system would never have developed, and certainly political partisanship would have been to some extent moderated by the existence of a Vice-President who had actually run against the President.

Although the Swiss adopted key parts of our Constitution, they specifically ruled out judicial review and provided a board rather than one person as the executive. The widespread use of direct voting and the general use of proportional representation made the Swiss constitution quite different from ours, but its basic structure remains very similar.

The main theme of this piece has been the lack of progress along the lines of the *Calculus* since it was written. The 25th anniversary of the book and the 200th anniversary of the Federal Convention in Philadelphia is a good time to both reflect on the past and resolve to do better in the future.

References

Buchanan, James M. "An Economic Theory of Clubs." *Economica* 32 (February 1965):1–14.

Shepsle, Kenneth A., and Weingast, Barry R. "When Do Rules of Procedure Matter?" *Journal of Politics* 46 (1984):206–21.

Tullock, Gordon. "The Welfare Costs of Tariffs, Monopolies, and Theft." *Western Economic Journal* 5 (June 1967):224–32.

[10]Providing the same arrangements for numbers of electors but having each one cast a single vote would easily achieve the objective.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Courts, Legislatures, and Constitutional Maintenance

Richard E. Wagner

Introduction

Gordon Tullock is certainly correct that several significant areas of research in public choice owe little or nothing to *The Calculus of Consent*. He is also correct that several areas of research suggested by the *Calculus* have attracted little interest from other scholars. Although I would support Tullock's call for more comparative research into constitutional arrangements as well as his lament about the paucity of such scholarship, I do not think his disappointment over the course of scholarly inquiry since publication of the *Calculus* should be very intense.

The *Calculus* was not an encyclopedic survey of a well-developed field of scholarship. Rather, it was a highly original foray into what was a nonexistent field, and no one should be surprised that many developments that subsequently emerged owed little or nothing to the *Calculus*. Yet, it is surely a rare book that can rival the *Calculus* in its influence over a body of scholarship. It was a seminal work in the development of public choice, and even after 25 years it still receives about 50 citations annually. Furthermore, the recent interest in bringing a constitutional focus to bear on questions of political economy can be attributed to the *Calculus*, with its concentration on constitutional principles and their implementation.

Most contemporary thought sees maintenance of a constitutional contract as an *external* process that relies on some specific enforcing agent, usually a court. By contrast, the *Calculus* articulated the logic of a self-enforcing constitution, under which constitutional maintenance is an *internal* process that depends on the incentives contained within the legislature. Tullock is right, I think, to argue that governments cannot be bound externally by specific constitutional provi-

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.
The author is Professor of Economics at Florida State University.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

sions, for the constitution will then be merely what that external authority declares it to be. For this reason, and as James Madison recognized in his negative evaluation of inserting a Bill of Rights into the constitution, there is great merit in pursuing the suggestion made by Tullock and the *Calculus* to look instead to the crafting of institutional arrangements that channel the operation of self-interest within the legislature in a direction that provides automatically for constitutional maintenance.

External Enforcement of Constitutional Contract

The model of the social dilemma, elaborated by both Buchanan (1975) and Tullock (1974), explains the mutual gains from social cooperation that people can achieve by adhering to some form of constitutional contract. But how to limit the scope for post-constitutional opportunism, which would erode those gains, raises the question of how to enforce and maintain the provisions of the constitutional contract. Consider Richard Epstein's (1985) analysis of the Fifth Amendment's limitation that any governmental taking of private property must be for public use and must be accompanied by just compensation. This limit reflects the principle that government should not be an instrument that some people use to enrich themselves by infringing on the rights of others. If two people acting privately cannot legitimately take the property of a third, neither should they be able to do so just because they form a political majority. The Fifth Amendment, if enforced, would prevent people from doing this very thing by acting in the name of government.

Yet, the theory of public choice has elaborated with contemporary analytical techniques what was common knowledge among the founders of our constitutional order: majoritarian democratic processes can, without proper constitutional constraints, easily accommodate the plunder of some for the benefit of others. Some people in a city will own developed property while others will own undeveloped property. Suppose that the owners of the developed property secure a zoning ordinance that restricts the development of the undeveloped property, as illustrated by *Agins v. City of Tiburon*.[1] Not only does the zoning ordinance decrease the value of the undeveloped property, but because it restricts the supply of competitive land, it also increases the value of the developed property. The zoning ordinance enables the owners of the developed property to effectively rob the owners of the undeveloped property, just as surely as

[1]447 U.S. 255 (1980).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the owners of the developed land had forcibly prevented the owners of the undeveloped land from developing their land.

Even though a constitutional contract may be written to prevent some people from using government as a means of plundering others, the maintenance of that contract requires some process of enforcement. The predominant emphasis in constitutional dialogue has been on enforcement through some external, sovereign authority. In contemporary America, that sovereign is generally regarded as the Supreme Court, which is commonly held to be the arbiter of what is constitutional and what is not. Constitutional dialogue accordingly operates through criticism of Court rulings and suggestions for alternative rulings. It also operates through disputes over the selection of justices. Possessing the ability to make and revise the rules of the game is valuable, and the greater that value the larger the investment people will make in trying to select or block particular nominees. It is not surprising that Court nominations have acquired the essential properties of interest-group politics, in that representatives of different interests campaign for the adoption of their preferred candidates.

It is debatable whether or not the Supreme Court is truly sovereign in matters of constitutional interpretation. Although the Court may rule against executive agencies and state governments, it rarely rules against Congress. James Madison was correct in asserting in *Federalist* No. 51: "In republican government, the legislative authority necessarily predominates." Within the central features of American republicanism, the legislature controls both the jurisdiction and the budget of the Supreme Court and has the ability to eliminate all courts inferior to it. And although the President does have the ability to nominate members to the Court, those nominees must be confirmed by the Senate. Furthermore, the President and the executive branch generally cannot act without appropriations from the legislature; and the legislature can fire the President, while at most the President can force the legislature to operate with a two-thirds majority through the veto power.

Unless the Court had an independent source of revenue, and one that somehow varied directly with the degree to which it prevented constitutional erosion, it is hard to see how the suzerainty of the legislature could be disputed. To model the judiciary as an agent of the legislature falls fully within the framework of American republicanism. If the Court is an agent of the legislature, even if some weighted average of past legislatures rather than simply the present legislature, as Landes and Posner (1975) argue, the legislature becomes the principal enforcer or interpreter of the Constitution. This was recognized by James Madison, who thought that constitutional con-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

trol was not so much a matter of dividing governmental authority among legislative, executive, and judicial branches as it was a matter of dividing "the legislature into different branches; and to render them, by different modes of election and different principles of action, as little connected with each other as the nature of their common functions and their common dependence on the society will admit" (*Federalist* No. 51).

Can "Interpretation" Be Distinguished from "Amendment"?

Is it possible to determine when a particular Court decision represents simply an interpretation of what the constitutional contract requires and when it represents a judicially imposed, though probably legislatively sanctioned, revision or amendment of that contract? With respect to *Agins*, for instance, is it merely a matter of interpretation whether or not the compensation was just and the taking was for a legitimate public use? Or do *Agins* and similar cases exemplify what is in effect an amendment of the Constitution, through which the "constitution" comes to allow the legislature to do whatever it chooses concerning private property unencumbered by any Fifth Amendment obligations, perhaps provided only that it asserts it has some public purpose in doing so? Relatedly, Tullock notes that the Court ruled through "interpretation" that states could not deny people the right to vote at eighteen years of age even before the Twenty-sixth Amendment had been ratified. Is there no test to distinguish acts of interpretation from acts of amendment? Must one person's reasonable interpretation be someone else's (un)constitutional amendment?

It is instructive to compare processes of constitutional enforcement with other processes of rule enforcement, such as those found in organized athletics.[2] The rules of a football game constitute its constitution, and it is the task of the referees to enforce the rules the participants have agreed upon. It is the participants and not the referees who choose the rules. Moreover, the ability to amend the rules is the province of the participants and not the referees. But how are referees, or judges, to be limited to enforcing rules and restrained from making rules, particularly when irreducible elements of judgment can always lead to some blurring through "interpretation" of the conceptually clear distinction between making and enforcing rules? The participants may agree to a rule against unnecessary

[2]Some of the argument presented here is developed more fully in Wagner (1987).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

roughness, but whether or not a particular instance of a hit on a quarterback constitutes unnecessary roughness requires the referees to interpret the participants' intent.

Despite the inescapability of interpretation, referees do not make the rules; they only enforce the rules that the participants have agreed to. What maintains the distinction between interpretation and amendment is the *consensual process* by which referees are selected and maintain their positions. Not only are they chosen by the agreement of the participants, but they also are subject to periodic and consensual reaffirmation by the participants. It is the presence of a consensual test involving a periodic reaffirmation of referees that makes it possible to determine if amendment has replaced interpretation. If judges are reaffirmed consensually, it is reasonable to infer that rules are being interpreted but not amended. By contrast, the absence of consensus among the participants would mean that the rules are being amended and property rights redefined for the benefit of some of the participants at the expense of others.

Internal Enforcement of Constitutional Contract

Although the model of the social dilemma illustrates nicely the potential gain that constitutional contract offers, the parchment that constitutional contract represents does not in itself assure maintenance of that contract. The actual process of constitutional interpretation and enforcement differs substantially from the type of process that is consistent with the maintenance of constitutional contract. For one thing, the Supreme Court is not analogous to the officials who work a game. If the members of the Court were selected consensually by the participants and were subject to periodic reaffirmation by the same process, then the Court would possess an analogous position. But the Court is not subject to periodic reaffirmation, and it is certainly not subject to any consensual affirmation by the participants who are asked to abide by its decisions. Indeed, the controversy that often greets Court appointments—along with the growing interest-group campaigning that has entered into lobbying over appointments to the Court—suggests that the Court is not part of a consensual process of rule interpretation, but is a participant in a process of rule amendment via "interpretation."

Within the framework of American republicanism, the Supreme Court has no enduring ability to maintain the constitutional contract, even if its members should wish to take on that assignment. The constitution largely will be what the legislature wants it to be. Therefore, maintenance of the constitutional contract will be possible only

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

if the legislature is constituted so that the interests of its members are more fully advanced by maintaining that contract than by amending it through legislation, as Madison recognized in *Federalist* No. 51 and elsewhere.

Knut Wicksell developed one of the primary illustrations of a self-enforcing constitution in 1896, although his contribution remained essentially moribund until the *Calculus* was published.[3] Wicksell's point of departure was how to take seriously, and not just formally or tautologically, the injunction that government should reflect the consent of the governed. Wicksell suggested two changes in legislative organization that would work in this direction: the selection of parliament through a system of proportional representation and a requirement that approximate unanimity instead of majority rule be required for the legislature to take action. Within such a legislature the scope for a winning faction to enrich its members at the expense of everyone else would be sharply curtailed, although it could not be fully precluded so long as less than complete unanimity was required and the system of proportional representation failed to reflect fully the various preferences and interests within the population at large.

To the extent that a system of proportional representation led to a legislature that was representative of the citizenry at large, approximate unanimity among legislators would correspond to approximate unanimity among the citizenry. It is very different with a system of single-member constituencies, where it is possible to secure unanimity within a legislature with the support of only a bare majority of citizens. When the legislature requires only majority approval, legislation comes to reflect even less of a consensus among the citizenry at large. Accordingly, the constitution would not serve as a limit on government, but would be something that government continually amended via a process of constitutional interpretation. Consequently, government would not be a follower of rules, as is envisioned by the models of constitutional political economy and by the very idea of constitutional government, but would be a maker of rules, as expressed by the proposition: The legislature can do no wrong, because it is the source of rights.

Parchment may cover guns, but guns can blow away parchment. Constitutional parchment cannot enforce itself; enforcement always requires guns. Whether enforcement maintains the original constitutional contract or replaces it depends on the arrangement of guns

[3]The relationship between Wicksell and *The Calculus of Consent* is explored in Wagner (forthcoming).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

or interests. The more fully institutional arrangements point guns toward the enforcement of the original contract, the more likely it is that the contract will be maintained. The idea of the self-enforcing constitution looks to the creation of institutional arrangements that make it unlikely that the constitution will be violated. The *Calculus* has done much to breathe life into the idea of a self-enforcing constitution, by redeveloping with contemporary modes of thinking some of the central insights that were pivotal to the creation of the American constitutional order.

References

Buchanan, James M. *The Limits of Liberty: Between Anarchy and Leviathan.* Chicago: University of Chicago Press, 1975.

Epstein, Richard A. *Takings: Private Property and the Power of Eminent Domain.* Cambridge: Harvard University Press, 1985.

Landes, William M., and Posner, Richard A. "The Independent Judiciary in an Interest-Group Perspective." *Journal of Law and Economics* 18 (December 1975): 875–901.

Tullock, Gordon. *The Social Dilemma.* Blacksburg, Va.: Center for Study of Public Choice, 1974.

Wagner, Richard E. "Parchment, Guns, and the Maintenance of Constitutional Contract." In *Democracy and Public Choice: Essays in Honor of Gordon Tullock*, pp. 105–21. Edited by Charles K. Rowley. Oxford: Basil Blackwell, 1987.

Wagner, Richard E. "*The Calculus of Consent:* A Wicksellian Retrospective." *Public Choice,* forthcoming.

Wicksell, Knut. "A New Principle of Just Taxation." 1896. In *Classics in the Theory of Public Finance,* pp. 72–118. Edited by Richard A. Musgrave and Alan T. Peacock. London: Macmillan, 1958.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE *CALCULUS OF CONSENT* AND THE CONSTITUTION OF CAPITALISM

Dwight R. Lee

Introduction

The functioning of a market economic order, or capitalism, is not discussed in *The Calculus of Consent*. The purpose of the public choice classic by Buchanan and Tullock was to examine the democratic political process from the analytical perspective of the modern economist.[1] The success of the *Calculus* in achieving this stated purpose is beyond question. We now have 25 years of impressive intellectual effort that builds on and attests to the success of the *Calculus* in opening avenues of insight into the political process. But in achieving this success, the *Calculus* also opened a field of research that significantly expands our understanding of the market order.

Every economy is a political economy and it is impossible to understand an economic system without taking into consideration the political environment within which that system operates. This is obvious in the case of a socialist, or centrally planned, economy where the distinction between economic and political decisions is blurred in the extreme. It is much easier to overlook the mutual interaction between economics and politics in the case of a market economic order where economic decisions are less directly influenced by political decisions. But the connections between politics and the market economy are no less important by virtue of being more subtle.

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.
The author is Professor of Economics at the University of Georgia.

[1]The closest Buchanan and Tullock get to discussing the market in the *Calculus* is when they state, "the market order is founded on the empirical reality that not *all* men renounce self-interest, and that, because of this, the pursuit of private gain should be put to social use where this is possible." Their next sentence, however, is, "The question that we have posed in this work concerns the possibility of extending a similar approach to political organization" (1962, p. 304).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Protecting Capitalism from Government

The distinguishing characteristic of any political process is coercive power while the distinguishing characteristic of the market process is voluntary exchange. By definition, coercion trumps voluntary action, and therefore the crucial political ingredient into the viability of a market order is restraint. As the analysis in the *Calculus* makes clear, strong and persistent tendencies in a democracy oppose government restraint. According to Buchanan and Tullock (1962, p. 287), this opposition comes from organized pressure groups

> because differential advantages are expected to be secured through the political process, and, in turn, differential advantages for particular groups are produced because of the existence of organized activity. A spiral effect comes into play here, the results of which may be observed in the federal income tax structure, federal tariff legislation, federal resource-development projects, and many other important areas of economic legislation in particular.

Such special interest political influence can undermine the market economy by allowing these interests to circumvent the discipline imposed by private property and voluntary exchange.

Much of the analysis in the *Calculus* explains why it is that government, which, in a market economy, has the responsibility for protecting private property rights, is so prone to violate those rights. The benefits generated by respect for private property are general benefits in the same sense as the benefits provided by public goods. Once the benefits are provided by the contributions of some they are equally available for the consumption of all. The temptation facing each individual is to reap the benefits and avoid the contribution. This is precisely the temptation of the individual who enjoys the general benefits of a productive market economy while using political influence to realize differential benefits by violating the property rights of others.

It is easy to get the impression from the discussion to this point that the characterization of political activity given by the *Calculus* is primarily negative. This impression would be wrong. The very harm that is imposed on society when people undermine the market process through predatory behavior reflects the good that is conveyed on society by a government whose role is largely limited to restraining predatory behavior. When subject to appropriate "rules of the game" the *Calculus* portrays government as the means of controlling predation and engaging in "complex exchange" that expands the opportunity of all.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

A fundamental contribution of the *Calculus* was to distinguish between decisions made within the political rules of the game and decisions made on those rules, or constitutional decisions. The same self-interest that motivates political activity aimed at negative-sum predation within the rules will motivate the design of rules that minimize this predation and promote the general welfare. The *Calculus* not only discusses the desirable characteristics of a constitution, it also explains why self-interest is difficult to distinguish from the public interest at the level of constitutional design, and therefore why desirable constitutional design is possible. As Buchanan and Tullock note (pp. 94–95):

> The constitutional choice of a rule is taken independently of any single specific decision or set of decisions and is quite rationally based on a long-term view embodying many separate time sequences and many separate collective acts disposing of economic resources. . . . The self-interest of the individual participant at this level leads him to take a position as a "representative" or "randomly distributed" participant in the succession of collective choices anticipated. Therefore, he may tend to act, from self-interest, as if he were choosing the best set of rules for the social group.

A constitution that imposes rules on the political process that make it responsive to the all-inclusive social group is indispensable to a capitalist economic order. It is entirely justified, at least in the mind of this author, to go one step further and argue that a constitution that creates a political process promoting the general interest will also promote a capitalistic order. Promoting the general interest requires allowing each individual the freedom to pursue his or her objectives in a setting that provides the information and motivation to do so in a way that expands the opportunity of all others to do the same. It is only through the market exchanges of private property under a capitalist order that people are able to advance their diverse interests in cooperative interaction with one another. No other economic order comes close to capitalism in fostering social harmony and widespread prosperity, that is, in promoting the general interest.

There are those who believe that creating a political order conducive to capitalism is not only what those who drafted the U.S. Constitution did, but that it is also what they intended. For example, Bernard Siegan (1982, p. 126) has stated, "The Framers of the original document [the U.S. Constitution] *sought* to create a society allowing free commerce in which the marketplace of goods and services was the ultimate economic authority" (emphasis added). This is not a belief, however, shared by all admirers of both the Framers and capitalism. According to Forrest McDonald (1982, p. 49): "If one

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

were to take a poll of American historians and ask what sort of economic system was contemplated by the framers of the Constitution, the most common answer would doubtless be capitalism. That answer is inaccurate."

It is not my intention here to take sides in an argument over what the Framers' intentions were with respect to capitalism. Rather, the argument here is that the fate of capitalism in the United States depended little, if any on the Framers' original intent toward capitalism. One can make an argument, as does Siegan (1982, pp. 106–7), that the preservation of constitutional government requires at a minimum "that a consensus exists among jurists and constitutional scholars that the intentions of constitutional framing bodies should be strictly observed when to do so would be advantageous or not harmful for modern society." But even if it were clear that the Framers intended to establish an economic order based on capitalism, the consensus Siegan discusses would offer little protection to that order under the view of government that prevails today.

Given the prevailing view that discretionary government power, widely exercised, is the primary source of social progress, almost any restriction imposed by the Constitution is seen as "harmful for modern society." Most people advocating constitutional reform today identify more with Pulitzer Prize historian James MacGregor Burns and those associated with the Committee on the Constitutional System than with Nobel laureate James Buchanan. The former seek to expand government while Buchanan seeks constitutional reform as a means of limiting government. However, accepting the majority view that we should unchain government so that it can get on with doing good renders the intentions of the Founders largely immaterial, even under Siegan's consensus.

It is simply not all that important what the Framers intended with regard to capitalism. Far more important were their intentions with regard to limiting government power. While the Framers recognized the importance of a government with sufficient power to perform a few basic tasks, they also had a profound mistrust of that power. It was their intention to make it sufficiently difficult to activate the power of government that it would be almost impossible for special interest coalitions ("factions" in Madison's words) to infringe on the rights of minorities.[2] Unless we can somehow recapture the wisdom

[2]The Federalist papers are full of quotes that clearly reflect the intention of Madison and Hamilton to restrain the power of government. The obstacles of government action built into the decision-making machinery of the federal government is an obvious reflection of the Framers' mistrust of government power. Also indicative is the fact that during the constitutional convention the Framers considered and rejected granting the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

of the Framers, as reflected in their distrust of discretionary government power, and reimpose genuine constraints on government, capitalism will be undermined even if the Framers did intend to foster it. On the other hand, if we once again restore effective constraints on government, capitalism will thrive even if the Framers did not intend to foster it.

Capitalism is a rather hardy organism in that it will flourish when left largely alone. It does not have to be applauded, appreciated, or given tender loving care to work its wonders. As McDonald (1987, pp. 1–2) points out, "the weight of law, tradition, philosophical values, and—especially after 1776—ideology was such as to make the emergence of a liberal regime seem almost impossible." Yet the fact is that a liberal regime of capitalism not only emerged, but within a few decades transformed the United States into the most prosperous country on earth. And the primary ingredient that went into this transformation was a stable, but limited, government that engaged in a minimal amount of meddling in the details of economic decisionmaking.

Capitalism is hardy, but not indestructible. The heavy hand of government can eventually squeeze the life out of a vibrant market order. Capitalism cannot survive in an environment in which political decisions constantly override individual economic decisionmaking. We would be better served if our current crop of politicians was less involved in "promoting" capitalism and more involved in limiting the scope of government. Invariably, when a politician sets out to advance the cause of capitalism, the result is another monkey wrench thrown into the market process. Has there ever been a piece of special interest legislation enacted that was not justified, at least in part, as a means of promoting capitalism? Bailing out Chrysler keeps capitalism strong at home, as do a host of tariffs and trade restrictions. Farm programs insure the survival of the backbone of competitive capitalism: the family farmer. Social welfare programs protect capitalism against its own excesses, as does a host of business regulations. Controls on the price and allocation of energy prevent our capitalistic system from being crippled by dependence on foreign petroleum. And the list goes on.

---

federal government the power to grant charters of incorporation; to establish seminaries for promotion of the arts; to establish institutions for the promotion of agriculture, commerce, trades, and manufactures; to regulate stages on the post roads; to establish a university; and to make sumptuary laws. And the list could be extended (see Seigan 1982, p. 113).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Conclusion

Without discussing capitalism, Buchanan and Tullock provided us with a profound understanding of the constitutional prerequisite for a political process consistent with a viable capitalistic order. Without necessarily intending capitalism, the Framers brought forth a constitution that satisfied these prerequisites. As Buchanan (1987, p. 309) has said regarding the analysis in the *Calculus:* "The construction seemed to offer justificatory argument for something akin to the complex political structure that James Madison had in mind, much of which finds itself embedded in the constitutional framework approved by the Founding Fathers."

The economic success of capitalism in the United States cannot be separated from the political success of the U.S. Constitution. Our economy is a political economy and has to be understood as such. This understanding has been greatly advanced by the *Calculus* and the scholarship of Buchanan and Tullock.

References

Buchanan, James M. "Justification of the Compound Republic: The *Calculus* in Retrospect." *Cato Journal* 7 (Fall 1987):305–12.

Buchanan, James M., and Gordon Tullock. *The Calculus of Consent.* Ann Arbor: University of Michigan Press, 1962.

Burns, James M. *The Deadlock of Democracy: Four Party Politics in America.* New York: Prentice Hall, 1963.

Burns, James M. *The Power to Lead: The Crisis of the American Presidency.* New York: Simon and Schuster, 1984.

McDonald, Forrest. "The Constitution and Hamiltonian Capitalism." In *How Capitalistic Is the Constitution?* pp. 49–74. Edited by Robert A. Goldwin and William A. Schambra. Washington, D.C.: American Enterprise Institute, 1982.

McDonald, Forrest. "Economic Freedom and the Constitution: The Design of the Framers." Paper presented at the Third Annual Critical Issues Symposium on "Government, the Economy, and the Constitution," sponsored by the Policy Sciences Program at Florida State University, March 1987. Forthcoming in *Public Choice and Constitutional Economics,* chap. 15. Edited by James D. Gwartney and Richard E. Wagner. Greenwich, Conn.: JAI Press, 1988.

Siegan, Bernard H. "The Constitution and the Protection of Capitalism." In *How Capitalistic Is the Constitution?* pp. 106–26. Edited by Robert A. Goldwin and William A. Schambra. Washington, D.C.: American Enterprise Institute, 1982.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Politics of Constitutional Choice

Thomas R. Dye

Politics and Markets

America's foremost political scientist Harold Lasswell (1936) defined politics as "who gets what, when and how." Paul Samuelson (1976), one of the nation's leading economists, wrote: "Economics is deciding what shall be produced, how, and for whom." The similarity of these definitions of politics and economics is clear. Conventional political science studied decisionmaking in governments; conventional economics studied decisionmaking in markets.

It is now widely understood that both politics and markets provide mechanisms for making social choices. Politics organizes people for collective choice, and once choices are made it relies on governmental coercion to implement them. Markets organize people for individual choice, and once choices are made markets rely on voluntary exchange to implement them. Both politics and markets function to transform individual demands into goods and services, allocate costs, and distribute burdens and benefits.

The most important question to confront societies in the world today may be: Should we rely primarily on government or on the marketplace to provide and distribute goods and services? The question itself—what are the proper relationships between governments and markets—is the topic of political economy.

Buchanan and Tullock (1962, p. 43) pose this question in the rational individualist terminology of "public choice" economics: "When will a society composed of free and rational utility-maximizing individuals choose to undertake action collectively rather than privately?" They answer the question with their own "cost approach to collective action." The individual, they contend (p. 61), "must consider the possible collectivization of all activities for which the private orga-

---

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.
The author is Florida State University Foundation Professor of Government and Director of the Policy Sciences Program.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

nization is expected to impose some interdependence costs on him" and to compare these costs "with those expected to be imposed on him as a result of collective organization itself." Presumably, the individual will choose the decisionmaking system that minimizes the net costs to him. Yet, the individual cannot assess this net cost until he knows what decision rule will be adopted for making subsequent collective choices in various activities. If the rule of unanimity is chosen, then the expected costs to the individual of collectivizing a decision are zero, because he will be assured that he alone can veto any action that imposes net costs on him. If the decision rule is a simple majority, however, the individual may be reluctant to risk his fundamental human and property rights to collectivization, because he knows that the majority may choose to do severe damage to him. "The appropriate decision-making rule for collective choice is not independent of the decision as to what activities shall be collectivized" (Buchanan and Tullock 1962, p. 48).

Thus, in the Buchanan and Tullock framework, all human activities are potential candidates for collectivization. Our fundamental freedoms—life, liberty, and property—are protected by the utility-maximizing individual's unwillingness to risk severe damage to himself by submitting these "activities" to collective decisionmaking under any rule other than unanimity.

Markets As a Political Decision

The public choice perspective views the decision about whether to rely primarily on individual market decisionmaking or collective governmental decisionmaking as a rational individual choice. However appealing such a notion may be in theory, it is not true in fact. The decision to establish a political economy on individualist, free-market principles or on collectivist, centrally planned doctrines is a *political* choice that emerges from political conflict—whether in the form of reasonable discussion, impassioned oratory, interest group pressure, party competition, electioneering, balloting, rioting, street-fighting, war, or revolution.

Political economies are not based on individual consent. The classical contract theorists, the precursors of modern public choice theory, recognized that they were developing moral precepts. Locke (*Of Civil Government*, ¶175) wrote: "Though politics can be founded on no other thing but the Consent of the People; yet such has been the disorders ambition has filled the world with, that in the noise of war, which makes so great a part of the history of mankind, this Consent is little taken notice of." Most political regimes, Locke acknowl-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

edged, are established by "conquest," "usurpation," or "tyranny." He challenged their moral legitimacy, not their ubiquity throughout history.

Understanding Political Choice

To understand society's choice between public and private modes of decisionmaking, we must learn what forces drive this *political choice*. Rational, material self-interest is only one of the many complex forces that provide political motivation for individuals and societies; and tautological revisions of public choice conceptualization of individual "utility" will provide very little help to us in understanding these forces.

Consider, for example, the possibility that mass political support for capitalism or socialism arises out of popular notions of justice and injustice. These notions provide an explanation for the "moral anger" that drives wars and revolutions and are distinct from, yet related to, philosophical conceptions of justice. These notions are also distinct from perceived individual self-interest (e.g., Rawls, Nozick) and from class interests. They are rooted in structural differences between markets and politics, but they are independent of these differences and even include various perceptions of them. Robert E. Lane (1986) recently developed this argument in an apparent attempt to advise his collectivist-minded colleagues in political science about the American public's confounding penchant for market justice over political justice and what might be done about it. But Lane's insights into the cognitive and affective attitudes of the public toward markets and governments are very instructive to those who cherish individual freedom and limited government.

There is abundant evidence in political science that popular evaluations of economic structures are independent of perceived material self-interest. We know that neither inequality nor deprivation are sufficient conditions to produce popular feelings of injustice or unfairness. People must not only want something, but they must also believe that they deserve it and they must come to expect it. Thus, deservedness and expectation are important components of justice and are independent of material well-being. In reality, these sentiments tend to provide political support for the marketplace. According to Lane (1986, pp. 394–95), "It is the genius of the market to stimulate wants without at the same time stimulating a sense of deserving more than one gets . . . if one believes that the outcomes are attributable to one's own acts—that the self is to be credited or blamed for one's own fate—one does not invoke justice sentiments."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

People believe that they can control their fate in the marketplace but not in politics. Opinion data constantly show strong support for American free enterprise, with respondents perceiving it as "giving everyone a fair chance" (McCloskey and Zaller 1985). In contrast, large majorities of people consistently take a dim view of government and politics; for example, "the government is pretty much run by a few big interests looking out for themselves" (Lipset and Schneider 1983).

Public evaluations of the marketplace and government are only loosely tied to perceived material self-interest. Political research shows that people vote more according to national *news* of unemployment than their own employment situation (Kiewiet 1983). Voters are more concerned with economic conditions in society as a whole than with their own financial situations. Massive new government programs to help the "homeless" win widespread support among Americans who have never been homeless and never expect to be, even when most Americans know that homelessness is primarily a result of alcoholism, drug abuse, and mental illness. Americans do not perceive these conditions to be market problems (much to the frustration of our Marxist colleagues) but as problems for the government. The public blames the government for poverty, unemployment, and homelessness, not the marketplace.

Political research also shows that popular attitudes toward income distributions are acquired quite independently of people's income. Americans at all income levels support wide disparities of income when they are perceived as a product of skill, knowledge, hard work, education, risk-taking, initiative, and even good luck. "A sense of deservedness is central to the concept of justice, at least among the lay public if not always among philosophers" (Lane 1986, p. 386).

Most Americans believe that they are receiving about what they deserve and what they expected to receive from life. This belief is crucial to the amount of political support there is for the American free enterprise system. But Americans are not satisfied with what they get from government. Taxes are "too high," and government is "wasteful," run for the "special interests," and is "too powerful." These evaluations of government predominated during the 1960s and 1970s but leveled off and declined during the 1980s, when confidence in government was somewhat restored. This new confidence may pave the way for increased reliance on government during the 1990s, making people more willing to rely on collective choice. Yet, on balance, Americans tend to believe that the market is fairer than government.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

If material well-being was people's sole motivation, then we would expect that all forms of income would be equally valued. But earned income is valued more than government transfer income. We cannot easily dismiss the expressions of welfare recipients that they prefer work to welfare or the expressions of farmers that they prefer market returns to governmental subsidies. And political support for social security has always depended on the myth that benefits were earned through contributions. Market income confers self-esteem; government transfer payments do not.

Public choice theory views both markets and politics as being driven by self-interest, but political scientists tell us that popular notions of right and wrong, of justice and injustice, motivate voters more than self-interest. The general public believes that self-interested behavior in the marketplace is appropriate and beneficial, if properly constrained; self-interested behavior in government is perceived as being evil. The self-interested or ambitious politician is the object of suspicion, so politicians spend a great deal of time and money creating a public image of themselves as unselfish, humble servants devoted to the public good. They prudently portray their own motivations in terms of "public service," "doing good," "helping others," and "civic duty." The voters would be unlikely to support a candidate who described his or her motives in terms of "getting reelected," "acquiring power," "becoming famous," or "wielding influence."

On balance, the American public favors markets over politics as a means of distributing burdens and benefits. Lane formulates the question of distributive justice in a way that parallels Lasswell's definition of politics: "*Who* distributes *what to whom*, in virtue of what *critical characteristics* by what *procedures*, with what distributive *outcomes*?" Lane contends that most Americans prefer markets over politics on each component of this question. According to Lane, people perceive the market to be a fairer agent of distribution than the political system. "They prefer the market's criteria of earned deserts to the political criteria of equality and need, and believe market procedures are more fair than political procedures. They are satisfied that they receive what they deserve in the market, but much less satisfied with what they deserve in the polity" (Lane 1986, p. 387). Finally, people accept unequal distributions of income resulting from market operations, but they are angered by inequalities of influence in the political system.

In short, the general public distinguishes between governmental and market decisionmaking and apply different standards of behavior

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

to each arena. Buchanan and Tullock argue that "the average individual acts on the basis of the same overall value scale when he participates in a market activity and in political activity." The thrust of empirical research, however, fails to support their assertion.

These observations should warn us that the fundamental constitutional choice between market and governmental decisionmaking will *not* rest exclusively on individual material self-interest. People must be convinced that the market is fair and just.

The Politics of Public and Private Choice

The market may be an enormously successful mechanism for generating wealth and relieving poverty, but if the market is perceived as unjust, it will be replaced by less efficient mechanisms, even if material well-being is lessened for everyone. Public choice theory may not perceive such an "irrational" outcome, but it is a very real prospect in the world of politics.

Even though market justice with its principle of earned deserts has popular appeal, so also do the principles of need and equality; and government is widely perceived to be the best mechanism for implementing these principles. Most people believe that government should provide for the needy and guarantee equality and that government should rectify any injustices created by the marketplace. Most people exhibit strong sympathy for the poor, the aged, the handicapped, the ill, the unemployed, and others for whom market returns are minimal. Even though transfer payments to these people violate the principle of earned deserts, they receive wide support.

When people confront political decisions, they tend to think of the welfare of all of society, that is, the "public interest." Perhaps politics is a cheap way to display one's altruism; all but an infinitesimal portion of the funds voted for various causes comes from other people's pocketbooks. But it is more likely that political decisionmaking, simply because it is collective decisionmaking, encourages people to think about others in making choices. Because market decisionmaking is an *individual* process, people are free to think mainly about themselves. But people understand that political decisionmaking in a democracy requires the consent of others and that policies must be formulated in the public interest.

Our knowledge of the political foundations of private versus collective choice is surprisingly limited. In contrast to the well-developed rationalist theory of constitutional choice in the public choice literature, political research on individuals' perceptions of and attitudes about markets and governments and the forces that shape them is skimpy at best. Our philosophical ideas about justice and fairness

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

have been elaborately developed (Rawls 1971; Nozick 1974), but our understanding of popular notions of justice and fairness is minimal. The wealth of theory contrasts sharply with the paucity of empirical observations. There are, of course, important exceptions to these generalizations (Hochschild 1981; Lipset and Schneider 1983; Lane 1986; McCloskey and Zaller 1985), but the political foundations of market economics are still not fully understood. Public choice theory can play a central role in helping us to understand societal choices between markets and politics, if only because rational calculation of material well-being is a powerful human motivation. But even when human behavior diverges from the predictions of public choice theory, the prediction is still valuable as an indicator of the extent to which other social and psychological motives are at work. Public choice theory, however, is not a substitute for research into the wide range of human motivations that shape societies.

We understand the *logic* of collective choice; we need to know more about the *politics* of collective choice. When will people choose to collectivize an activity? What ideas, perceptions, and motives will drive them to do so? What is the public understanding of the concepts of public goods and externalities? What is seen as fair or unfair about the marketplace? Do people distinguish between fairness in procedures and fairness in outcomes? Is fairness understood in individual terms or in terms of group, class, or race? Does the public perceive equality as equality of opportunity or equality of outcome? When and under what conditions will people employ different definitions of equality? Do popular notions of fairness and equality change over time; if so, what societal conditions affect these changes? How is governmental decisionmaking popularly perceived? When is majority decisionmaking perceived as illegitimate? What conditions affect the public's view of the fairness, legitimacy, power, and wastefulness of government?

Even though we need to know more about popular perceptions of markets and governments, we also need to know how these perceptions affect society's decisions to collectivize or privatize activities. Do constitutional choices reflect mass opinion, or do they reflect the interests of political elites, which may not be congruent with mass opinion? Is mass opinion shaped by elites, or are elites heavily constrained by mass attitudes? Whose interests are better served by market decisionmaking and whose are better served by governmental decisionmaking? We have acquired some important insights into these kinds of questions, but a heavy agenda of political research awaits us if we are to fully understand the politics of constitutional choice.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

References

Buchanan, James M., and Tullock, Gordon. *The Calculus of Consent*. New York: John Wiley, 1962.

Hochschild, Jennifer L. *What's Fair? American Beliefs About Distributive Justice*. Cambridge: Harvard University Press, 1981.

Kiewiet, Roderick D. *Macroeconomics and Micropolitics*. Chicago: University of Chicago Press, 1983.

Lane, Robert E. "Market Justice, Political Justice." *American Political Science Review* 80 (June 1986): 383–401.

Lasswell, Harold D. *Politics: Who Gets What, When and How?* New York: McGraw Hill, 1936.

Lipset, Seymour Martin, and Schneider, William. *The Confidence Gap: Business, Labor, and Government in the Public Mind*. New York: Free Press, 1983.

McCloskey, Herbert, and Zaller, John. *The American Ethos: Public Attitudes Toward Capitalism and Democracy*. Cambridge: Harvard University Press, 1985.

Nozick, Robert. *Anarchy, State, and Utopia*. New York: Basic Books, 1974.

Rawls, John. *A Theory of Justice*. Cambridge: Harvard University Press, 1971.

Samuelson, Paul. *Economics: An Introductory Analysis*, 9th ed. New York: McGraw Hill, 1976.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Procedural and Substantive Constitutional Protection of Economic Liberties

Peter H. Aranson

Introduction

Recent history and the Bicentennial of the U.S. Constitution have revived interest in long-standing questions about the Republic's constitutionally constructed political and judicial institutions. This paper focuses on the role of one institution—the federal judiciary, and especially the Supreme Court—to discern the nature of its place in setting the metes and bounds of the relationships between federal and state political branches on one side and citizens' economic rights on the other.

The first section describes and criticizes three currently prominent theories of constitutional interpretation: the interpretivist position, espoused most recently by Attorney General Edwin Meese III and Chief Justice William H. Rehnquist; the noninterpretivist position, often embodied in the opinions and other writings of Associate Justice William J. Brennan; and the procedural–protections position, as developed in the work of Professor John Hart Ely. The essay then reviews the place of procedural and substantive protections in constitutional argument and discerns the fundamental weaknesses in the interpretivist, noninterpretivist, and Ely positions: None of the positions addresses the problem of rent-seeking, by which minority interests and their coalitions engage the political process to reduce the welfare of members of the majority. The analysis is then applied to two recent Supreme Court cases, *Supreme Court of New Hampshire v. Piper* (470 U.S. 274 [1985]) and *Metropolitan Life Insurance Co. v. Ward* (470 U.S. 869 [1985]). The essay concludes by examining

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.

The author is Professor of Economics at Emory University. He thanks Thomas Arthur, William Mayton, Fred McChesney, and Thomas Morgan of the Emory Law School for their helpful comments on an earlier draft of the paper.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

some recently proposed constitutional correctives to the problem of rent-seeking.

The Search for Principles: Interpretivists, Noninterpretivists, and Proceduralists

The central questions about the constitutionally derived relation between the government and the governed in the American Republic, which have for so long dominated constitutional argument, form a hierarchy of principal and subsidiary questions with respect to the federal judiciary. First, should federal courts apply the Constitution to such relationships in conformance with that document's words—the interpretivist position—or should they seek applications that rest on a discovery of other values, which arguably inhere in the document itself or that go beyond such values–the noninterpretivist position? Second, does the Constitution, so read, oblige or empower the federal judiciary to place procedural or substantive constraints on the actions of either the federal or the state political branches? Third, if the Constitution so obliges or empowers the federal judiciary to constrain any of the political branches with respect to citizens' rights, then what constraints are appropriate?[1]

The principal antagonists in today's debate concentrate on the first question and then perhaps too easily reach answers to the second and third questions. Interpretivists, for example, claim that judges in constitutional argument must interpret the Constitution as it is written and apply the resulting imperatives to the cases before them (*Marbury v. Madison*, 1 Cranch. 137, 2 L. Ed. 60 [1803]). Finding no plain meaning in the text, judges must then try to discern what the words of the original document meant to the Framers. Should that exercise fail, judges must come as close as they can to discovering the requirements that the text imposes, according to the Framers' original intentions about such matters as federal structure (*Gibbons v. Ogden*, 9 Wheat. 1, 6 L. Ed. 23 [1824]). At some point, however, judges must be willing to break off from this exercise, declare the rights pleaded for as not within the compass of the Constitution, and send the parties to a different forum (or none at all) for the resolution of their conflict.[2]

[1]My concern throughout this essay is with constraints limiting the ability of the political branches to erode citizens' economic liberties, but I suspect that much of the analysis applies as well to matters of civil rights and civil liberties. See infra, note 18.

[2]See, for example, Jackson v. City of Joliet, 715 F.2d 1200 (7th Cir.), *cert. denied*, 465 U.S. 1049 (1983), as discussed in Currie (1986). At issue was a suit brought against the City of Joliet, whose police officers chose to direct traffic instead of inquiring about the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

To answer the second question, most interpretivists believe that the Constitution obliges or empowers federal judges and Supreme Court justices to interfere with the political branches only in extreme cases. In these bodies, interpretivists opine, resides the power to make laws, as Article I delegates it to the Congress and the Tenth Amendment "to the States respectively, or to the people." Said with firmer particularity, and to answer the third question, federal judges and Supreme Court justices must not substitute their own public policy preferences (or self-discovered "fundamental values") for those revealed by federal, state, or local political branches. Accordingly, many substantive economic policy problems seldom can elicit principled constitutional constraints from the federal judiciary.

Noninterpretivists, by contrast, regard the Constitution's "open texture" as an invitation to discover "fundamental values" emanating from the document. They take this perspective not merely to fill in the interstices that its passages leave empty, but to go beyond the text's plain meaning, sometimes extending to "penumbras formed by emanations from" the "specific guarantees in the Bill of Rights," which "help give them life and substance."[3] Hence, noninterpretivists answer the first question by asserting that plain meanings elude

---

presence of and rescuing occupants of a burning car. The occupants died, and their heirs sued under the Fourteenth Amendment's due process clause, arguing that the city had deprived the victims of life without due process of law. In *Jackson*, Judge Posner wrote that the Constitution

> is a charter of negative rather than positive liberties. . . . The men who wrote the Bill of Rights were not concerned that Government might do too little for the people but that it might do too much to them. The Fourteenth Amendment, adopted in 1868 at the height of laissez-faire thinking, sought to protect Americans from oppression by state government, not to secure them basic governmental services (715 F.2d at 1203).

For an insightful discussion of related issues, see Williams (1983).

[3]In Griswold v. Connecticut, 381 U.S. 479 (1965), the Court reviewed the conviction under a Connecticut statute of the executive officers and medical directors of the Planned Parenthood League of Connecticut. The statute made the use of contraceptive devices a criminal offense, and the defendants had been convicted as accessories in giving out information and recommendations concerning contraceptive use. Justice Douglas struck down the Connecticut statute thus: "The foregoing cases suggest that specific guarantees in the Bill of Rights have penumbras, formed by emanations from those guarantees that help give them life or substance" (id. at 484). Douglas then invoked most of the Bill of Rights in describing various "penumbras" and "emanations," though the Framers plainly did not have birth control in mind when they wrote the Constitution, nor did the writers of the Bill of Rights or of the Fourteenth Amendment concern themselves with this issue.

In my view, Justice Douglas reached the correct result in *Griswold*, but he might have grounded the decision in a reinvigorated contracts clause instead of bending the Bill of Rights beyond recognition. On the potential importance and reach of the contracts clause, see Epstein (1984). Alternatively, Justice Douglas might have based his decision in *Griswold* on a reading of the First Amendment favorable to defendants.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

us, because the Framers' intentions are neither obvious nor unanimous; that plain meanings often are absent, because the Constitution does not speak specifically to a variety of issues; and that from time to time the document contradicts itself, even under the most narrow or alternatively expansive readings that are tailored to make interpretation coherent. Noninterpretivists then answer the second question affirmatively and the third most generously by discerning values that they find below, or even beyond, the text's written words.

The terms "interpretivist" and "noninterpretivist," of course, describe neither exhaustive nor exclusive categories. In the absence of textual clarity, the interpretivist sometimes must rely on finding values or structural implications in the body of the Constitution, and the noninterpretivist's task *perforce* must begin with interpreting the Constitution's words and the Framers' intent. More importantly, those speaking for either side of this debate easily can undermine the certainty of the law. An interpretivist position remains capable of finding in the document both majoritarian and antimajoritarian implications, while a noninterpretivist position can enshrine values distinctly at odds with those that many noninterpretivists now embrace.

Nor is that all. The hierarchical structure of our three questions leads us through paths whose end points are not independent of the questions' ordering. For example, if we place the third question first (how should courts constrain the political branches?), then a negative answer to the second question (can they do so?) would make the entire Constitution irrelevant to the subject of our inquiry. A positive answer would leave it to those who answer the first question to define the manner of discovering constraints on the political branches. If we begin with the second question, then we are led into the landscape in which the Court-versus-legislature debate ordinarily is waged, namely, the problem of judicial review in a democracy. Embedded in this second question are the other two: What, if any, legislative acts should the judiciary review (question three), and what does the language of the Constitution imply about judicial limitations on the political branches (question one)?

Interpretivists appear to distrust judicial review, because of the way in which they answer the first two questions. But in an earlier time, their conservative judicial forebears were eager to have the Supreme Court declare the New Deal unconstitutional on what now appear to be noninterpretivist (substantive due process) grounds.[4]

[4]Concerning state economic regulation, the key case is Lochner v. New York, 198 U.S. 45 (1905). This passage should not be read, however, to imply that one could not justifiably invalidate the New Deal on what turned out to be interpretivist grounds. See Epstein (1985).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Likewise, noninterpretivists now acquiesce in judicial review, although their liberal judicial ancestors earlier regarded it with as much distrust as interpretivists do today. The members of both camps appear to have consulted their policy preferences and fashioned their constitutional jurisprudence accordingly. At least the statistical correlation seems nigh on perfect.

John Hart Ely (1980), who has established the terms of much of this debate, tries to find a dimension of judicial review orthogonal to those fought over by interpretivists and noninterpretivists. He begins his analysis by showing the inherent difficulties of interpretivism. He then rejects the search for fundamental values, whether they are derived from natural law, tradition, consensus, reason, neutral principles, or whatever other animating spirit the justices or commentators might seek to discover. Finally, he tries to reconcile the operation of judicial review with that of democratic governance by finding in the Constitution the judicial obligation to perfect democratic governance itself.

In searching for judicial amelioration, Ely would not have courts second guess legislative public policy decisions per se. Instead, he would have them ask: Has the majority not merely placed a minority at a relative disadvantage in terms of legislatively derived benefits conferred or costs imposed, but also has it done so because of imperfections in the system of representation, perhaps created by the majority itself? If so, the courts might try to fashion a remedy by relying on a theory of virtual representation, where representation is formally impossible. For instance, in cases involving state taxation or regulation of foreign (out-of-state) corporations or persons, courts might impose on state legislation the even-handedness required by the commerce, privileges and immunities, or equal protection clauses. A court might insist that a state legislature could not tax foreign liquor producers at a higher rate than it taxes domestic producers (*Bacchus Imports Ltd. v. Dias*, 468 U.S. 263 [1984]). When taxed at equal rates, the theory suggests, domestic producers will "virtually represent" foreign producers in the state's political process.

Where direct representation remains possible, courts might perfect it by requiring equal apportionment, eliminating discriminatory gerrymandering, and removing more explicit racial or property qualifications for the franchise. If representation, so perfected, fails to produce a parity of legislatively created benefits and costs, then the courts must examine the causes of the inequality, perhaps by discerning whether or not the disadvantaged group is a "discrete and insular" minority, that is, one whose representatives in the legislature enjoy no parity in the policymaking process because of preex-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

isting prejudices (*United States v. Carolene Products Co.*, 304 U.S. 144, 153 n. 4 [1938]).

Two problems seriously afflict Ely's approach to resolving the dilemma of judicial review. First, if a court discovers that a disadvantaged group remains a "discrete and insular minority," even though it might share full participatory and representational rights, then the court may fashion a remedy in terms of public policy. That is, the court must go through the mental experiment of deciding what benefits or costs the group would have enjoyed or borne from the legislative process had it not been a discrete and insular minority; then the court must supply them. Such an experiment begs for unprincipled judicial construction. More importantly, as recent advances in public choice theory demonstrate, the task is daunting and ordinarily impossible.[5] Again, such a rule of judicial decisionmaking invites judges to substitute their own preferences for those that the legislature might have revealed, had it operated without prejudicial characteristics.

Second, Ely seriously misapprehends the problem of democratic governance (as do both interpretivists and noninterpretivists). Nearly all of Ely's analysis explains what courts should do to protect minorities, at least in their participational and representational rights, against an aggrandizing majority. He surely reads the *Federalist Papers* in this light, and all of his subsequent prescriptions address this problem. But that is not the only or even the most important problem of democratic governance, nor was it the problem that wholly concerned the Framers. The problem is that of minorities—cohesive interest groups—exacting benefits from the public sector at collective cost. But the reinforcement of this problem's institutional groundings is one of the principal solutions to impermissible majoritarian dominance over minorities that Ely would have the courts impose on the political branches.

In terms of actual values and preferences, Ely recognizes that majorities seldom arise in the legislative process. Instead, legislation reflects the act of coalition-building, in which a variety of groups, probably in disequilibrium, form and re-form around certain issues. Pork-barrel politics provide a good example. Citizens of Boston have no particular wish to confer a new port facility on citizens of New York City, Baltimore, Savannah, or New Orleans. But the member

[5]If there is no equilibrium motion in the legislature (one that defeats or ties all other motions), then we cannot predict what the legislature would have done had the minority in question not been walled off from the give-and-take of legislative coalition-building politics. See, for example, Riker (1982a).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

from Boston votes for these other projects in an omnibus rivers-and-harbors bill, because it is the only way that he can get the other minorities to agree to have the public treasury underwrite his own city's harbor improvements. Legislative minorities coalesce in this process, providing benefits to each. Ely would have the courts "unblock" minority access to the legislature; if that strategy should fail to produce the benefits of representation for discrete and insular minorities, then courts must rectify public policy itself. Ely believes that the forming of temporary majorities on votes, but not on preferences, ordinarily will ensure that majorities do not exclude minorities from benefits nor impose undue concentrated costs.

In recognizing the interest-group nexus of the legislative process, Ely is uncommonly modern. He makes a partly convincing case that the courts, merely by unblocking access through perfecting process, will help to ensure that all values emanating from the people will be heard, leaving the political branches to make sounder judgments with better information than otherwise might seem possible.[6] That is, the judiciary leaves value judgments to the legislature, but it seeks to ensure through procedural guarantees that all values (minority interests) find voice in the legislature.

Where Ely goes wrong is in believing that majority governance based on legislative votes bears a clear relationship to majority governance based on citizens' values. Reflecting the Framers' explicit concerns, public choice theory has (re)discovered a serious failure in the operation of the political branches. This failure—variously called hyper-pluralism, rent-seeking, and the collective provision of private benefits—focuses precisely on the nature of majority *voting* coalitions to show that they are not identical to majority *preference* or *value* coalitions.[7] Small, cohesive groups use the political process to accomplish the distributional goals of providing themselves with benefits (or lowered costs) that they cannot or would not purchase in the private sector. Cost-spreading through the "fisc" induces a rational ignorance of this process on the part of the disadvantaged *majority*. Legislators then face incentives to make decisions on distributional margins and not on allocative ones (Mayhew 1974; Fiorina 1977).

Ely persuades us that the Supreme Court's constitutional jurisprudence, perhaps at least partly through perfecting process, *inter alia*

[6]On the incorporation of minorities into legislative majority coalitions, see Miller (1983) and Riker (1982b).

[7]See, for example, Aranson and Ordeshook (1985); Buchanan, Tollison, and Tullock (1980); and Weingast, Shepsle, and Johnsen (1981). The models reported in these essays differ materially from one another, but their conclusions remain surprisingly alike.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

seeks to protect minorities from majorities.[8] But his judicially crafted solutions to the problems of disadvantaged minorities arguably are worse than the disease they seek to cure; they leave the majority even more unprotected against ever-shifting, predatory coalitions of minorities. Today's interpretivists also appear to form their constitutional preferences around distributional margins, as their variegated theories of interpretation tend to sanction redistribution of resources at the state level from uninformed majorities to cohesive minorities, usually to serve some imagined public purpose. Noninterpretivists, of course, look for standing in trees and every other interest group with a claim of positive rights against the majority's traditional claim to negative liberty.

The inescapable conclusion seems to be that neither the interpretivist nor the noninterpretivist nor Ely's position will do. The Constitution places both procedural and substantive limits on the political branches, derived from the Framers' explicit words and understanding that both kinds of limits protect minorities *and* majorities. Today's interpretivists would ignore these limits in asserting a nearly unalloyed form of legislative power, which they mistakenly regard as embodying majority will. Noninterpretivists show less concern for majorities and more for particular kinds of minorities; but they consult their own preferences, not the Constitution, in deciding to further the interests of some minorities but to denigrate the interests of others. Ely's position, of course, largely ignores the Constitution's substantive limits, relying instead on the very imperfect instrument of naked procedural constraints, but only to protect minorities.

Nor do the interpretivist and noninterpretivist positions appear to be historically valid or principled. For example, with respect to some interpretivists' denial of Fourteenth Amendment incorporation of the Bill of Rights as limitations on the power of state governments, Senator Howard, chairman of the joint committee that drafted the amendment, stated:

> Such is the character of the privileges and immunities spoken of in the second section of the fourth article of the Constitution. To these privileges and immunities, whatever they may be—for they are not and cannot be fully defined in their entire extent and precise nature—to these should be added the personal rights guaranteed and secured by the first eight amendments of the Constitution. . . . [A]ll these immunities, privileges, rights, thus guaranteed by the Constitution or recognized by it, are secured to the citizen solely as a citizen of the United States and as a party in their courts. They do not operate

[8]See, for example, Baker v. Carr, 369 U.S. 186 (1962), and Reynolds v. Sims, 377 U.S. 533 (1964).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

> in the slightest degree as a restraint or prohibition upon State legislation. . . . The great object of the first section of this amendment is, therefore, to restrain the power of the States and compel them at all times to respect these great fundamental guarantees.[9]

So much, then, for Attorney General Meese's (1986, p. 8) misplaced interpretivist claim that "since [1925] a good portion of constitutional adjudication has been aimed at extending the scope of the doctrine of incorporation. But the most that can be done is to expand the scope; nothing can be done to shore up the intellectually shaky foundation upon which the doctrine rests."

Justice Brennan, a noninterpretivist, does not fare much better against the historical record. His remark (1986, p. 23), that "as I interpret the Constitution, capital punishment is under all circumstances cruel and unusual punishment prohibited by the Eighth and Fourteenth Amendments," fails by any reasonable standard of constitutional interpretation. While we could imagine *some* circumstances in which capital punishment is cruel and unusual punishment, it surely is not so in *all* circumstances. The Constitution's text also makes plain the possibility of imposing such a penalty. Thus, Brennan seems no more persuasive than does Meese. Each reads the text and historical record in a most peculiar way to bring about the public policy results of which he approves. Neither Meese nor Brennan seems capable of laying a claim to principled or historically valid argument or judgment.

Should we try to award a victory in this debate between two positions that seem incorrigibly wrong? Some may find virtue in a debate that is not capable of resolution on its present terms. Perhaps political and economic stability, not to mention the preservation of rights, relies upon a degree of uncertainty in the persuasiveness of any argument at the constitutional level. If so, then that uncertainty, as well as the stability that relies on its existence, is always at risk from a different argument, one that completely refashions the fundamental dimensions on which the debate has proceeded. I do not suggest such a complete refashioning here, but I do suggest that we change the dimensions of the debate to consider what Brennan and Buchanan (1985, ch. 1) have called "constitutionalism" and that we thereby remove the debate to a different level of discourse.

[9]*Congressional Globe,* 39th Cong., 1st sess. 2765-66 (1866). As quoted in Ely (1980, p. 26). It is only fair to point out, as Ely does in his discussion, that this speech appears to be the only mention of incorporation in congressional debates over adoption of the Fourteenth Amendment. But the quotation at least clearly puts to rest the notion that incorporation was on no one's mind.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Constitution, Uncertainty, and Procedural Management

We begin by asking a question that remains surprisingly absent in constitutional dialogue: What is the function of a constitution? Lawyers, law professors, and judges are more interested in asking: What does *this* Constitution require? They answer that it requires that judges read it strictly, discerning original intent as closely as possible according to what is contained in the "four corners" of the document (Meese); that judges read it liberally and explore its fundamental values or other values and what those values imply under modern conditions (Brennan); or that judges not worry too much about values but instead reflect on process, making the institutions that the Constitution describes mirror more perfectly the preferences of all citizens (Ely). These answers seem premature, because they preempt the answers to other questions—answers that might affect the derivative consequences for the nature of both interpretation and public policy judgments within constitutional argument. But a constitution serves, *inter alia*, both a managerial and a value function. It does so in a particular sort of way, involving uncertainty about the time-bound goals of the process to be managed and about what values are permissible outcomes from the process so managed.

It is difficult to overstate the central place of uncertainty in constitutional construction. Consider the managerial function. A constitution and our Constitution set up allocations of responsibilities and empowerments between and among the federal government, the state governments, and individual citizens. Our Constitution also develops very clear procedures for the federal political branches (Article I), although it speaks far less clearly with respect to the states, with the exception of its impact on election law and representation. These provisions plainly reflect some value judgments concerning appropriate limits placed on both value inputs (citizens' and legislators' preferences) and outcomes of the political branches (public policy).

But it is not those limits and values that we wish to consider just yet. Instead, we concentrate here on the document's managerial functions. The Constitution, for example, specifies with great precision the path that a bill must take to become a law. This path seems not to vary, as the Court most recently has pointed out in striking down the legislative veto (*I.N.S. v. Chadha*, 462 U.S. 919 [1983]) and parts of the Gramm-Rudman-Hollings Act (*Bowsher v. Synar*, 106 S. Ct. 3181 [1986]). Now, by exploring two separate informational conditions, we may describe the purposes that this constitutional pro-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

cedural particularity serves in defining the manner in which the federal legislature and executive must enact legislation.

Suppose that the Framers enjoyed perfect foresight concerning all of the issues that would come before the President and Congress for the next century. Under these conditions, which correspond roughly to the perfect information condition in first semester price theory, the Framers at least would have varied the nature of the decision rules and legislative paths that each bill must take to reflect either their own preferences and known relative prices or the (perfectly known) preferences and relative prices that their progeny would face. This much we learn from public choice theory: given preferences, the rules of procedure determine the outcomes.[10] Failing that, and given perfect information but no transactions costs, the Framers even might have set out to settle all future political conflicts themselves, passing laws in 1787 to go into effect at appropriate times in the future. The century-long horizon may seem too great, but certainly a quarter-century or even a decade is not unimaginable. Yet, the Framers did not try to settle all future policy decisions through constitutional provisions. Instead, they imposed a difficult legislative decision process, one even more difficult to change, for *all* legislation.[11]

This hypothetical situation may seem to be nonsensical, but it serves to indicate exactly why the Framers constructed the elaborate legislative process that they did.

1. They could not anticipate what issues would arise, so they saved future generations the substantial decision costs of creating decision procedures anew with each subsequent proposal.

[10]For accessible discussions of this proposition, see Riker (1980); McKelvey and Ordeshook (1984); and Shepsle and Weingast (1984).

[11]The Framers did set different procedural rules for the disposition of different kinds of legislative actions. The House issues an impeachment (Article I, section 2), but conviction requires a two-thirds vote of the senators present (Article I, section 3). The ratification of treaties similarly requires a two-thirds vote of senators present (Article II, section 2), and senatorial advice and consent is required for the confirmation of ambassadors, cabinet secretaries, and federal judges (Article I, section 2). "All bills for raising Revenue," furthermore, "shall originate in the house of Representatives . . ." (Article I, section 7).

We may explain these variations in decision rules by referring to the theory that Buchanan and Tullock develop in *The Calculus of Consent* (1962). What is important here is not that the Framers decided to impose different decision rules for different *kinds* of actions (e.g., ordinary legislation *versus* treaties). The hypothetical case of perfect information implies instead that the Framers should have imposed different decision rules, say, for different *kinds* of treaties or even for different treaties themselves. That they did not do so supports the claim that they could not know what kinds of treaties the Senate would consider, or that they did not trust the Senate not to classify a "significant" treaty (requiring a two-thirds vote, for example) as a "technical" one (perhaps requiring only a majority vote of those present).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Because rules, given preferences, do determine outcomes, the Framers prevented what was likely to occur (and to some extent still does occur in arguments over procedure in each congressional chamber): a redundant dispute over rules that is really a dispute over outcomes.

2. The Framers could not anticipate the conditions (relative prices and production possibilities), and to some extent preferences, that the members of future generations might confront, but they reduced the possibility of legislative "experts" exploiting those less well informed by making the lawmaking process constant and explicit. That is, they increased the likelihood that more citizens than fewer could understand the lawmaking process, rely on its relative immutability, and thus have their preferences registered in the political process.[12]

The Framers did anticipate particular issues, and these anticipations stand behind certain procedural constitutional provisions in, for example, the population-based representation in the House but state-based representation in the Senate. The Framers might have resolved the expected policy problems in a "nonconstitutional" way by tacking specific provisions onto the Constitution. They did so, to some extent in terms of substantive limits, by including Article I, Section 9, which prohibited congressional action against the importation of slaves before 1808.

If the managerial function of a constitution flows from uncertainty about the nature of future issues, relative prices, preferences, and other conditions, then we must understand (with Hayek 1981, vol. 3, ch. 17) that the *organization* of a government through constitutional design is preeminently a planning process that purposefully may suppress procedural spontaneity. That is, for some of the specific decisions that the political branches make, there may be better (less

[12]In an important series of papers, Ronald Heiner (1983, 1986, 1988a, 1988b) discerns a connection between the presence of uncertainty and the use of rules, as distinct from calculation, to guide choice. Heiner observes that as the decisional environment grows more complex or as the decision maker enjoys less competence with respect to the environment's complexity, there will be a substitution away from specific calculation attending each decision and toward the use of rules, sometimes heuristics, to make decisions. For example, lower animals that confront the largest gap between calculating ability and environmental complexity rely far more heavily on the "rules of instinct" than do human beings. Heiner's insight has influenced much of my thinking about the function of a constitution and the importance of not departing from its prescribed rules. The lawmaking environment has grown increasingly complex in recent years, but human ability to calculate has improved much less. Hence, even with benevolent legislators, we should require a closer conformance with constitutional requirements. This appears to contradict arguments that the increasing complexity of modern government requires a "bending" constitution.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

costly) ways to make them than the way the Constitution specifies. But adherence to constitutional processes, like adoption of strict liability in tort as compared with a rule of negligence that requires constant calculation, seems institutionally efficient (cf. Rizzo 1980) for governing decisions about future enactments whose subjects we cannot anticipate.

The Constitution, Uncertainty, and Values

Ely correctly discerns that the managerial regularization of procedure provides an important though imperfect check on the majority exploitation of minorities, but procedural safeguards do not work as well to check minority exploitation of majorities. This important asymmetry stands at the heart of most theories of rent-seeking through legislative processes, and it requires explanation. It also begins our explanation of the evident values, in terms of substantive limitations on the political branches, which we find throughout the Constitution.

Managerial regularization of procedures aids minorities in limiting their exploitation by majorities through the process of rational ignorance. Downs (1957, pp. 207–67) first explained this phenomenon with respect to the incentives that different kinds of persons and groups would have to gain information about the political process and about the positions on public policy issues held by various politicians. In Downs's view, the value of investing in additional political information is in distinguishing correct from incorrect decisions. For example, without better information a citizen might cast a vote for a candidate whose election would have worse consequences for him than would the election of the candidate's opponent. But because the probability that the citizen's vote might affect the election outcome is so small in large electorates, most of the time most citizens will remain "rationally ignorant": they will choose not to invest in acquiring additional political information.

Exceptions may occur if the citizen has paid a sunk cost of acquiring information with political content or if he belongs to an organization that will do so for him–one that enjoys substantial economies of scale in performing these tasks. Either possibility seems most likely if the citizen is a member of a specialized group, such as a producer group, but not if he is a member of the group of all consumers or taxpayers. Specialized consumer groups or groups of ethnic, racial, or religious minorities also might be in positions analogous to those of producer groups with respect to this mechanism.

It follows that the members of small, cohesive groups might enjoy relatively superior information about candidates' and officeholders'

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

positions on issues that affect them differentially, about the stages in the legislative process wherein legislation that affects them now resides, and about the appropriate legislative body on which to exert influence. The regularization of procedure through constitutional design might make it less costly for minorities to protect themselves against aggrandizing majorities than for rationally ignorant and unorganized majorities to pass aggrandizing legislation against minority interests.

While this interpretation of procedural protection differs from Ely's by filling in the details in terms of an actual political explanation and mechanism, it also denotes the limits of such protection. First, a minority nested within a larger minority or a minority nested within a majority ordinarily may act alone to initiate lawmaking procedures. The configurations of political conflict commonly place these two kinds of minorities at odds over the passage of legislation. For example, specific occupational groups may represent minorities nested within the majority of white or native-born workers or of workers residing within a particular state. Minorities nested within the majority sometimes find themselves competing with price-cutting nonwhite or alien workers or with workers or firms residing elsewhere. Given the presence of rational ignorance, constitutionally prescribed federal legislative procedures and parallel procedures at the state level are likely to favor the minority nested within the majority over its new competition. Much federal immigration, state licensing, and regulatory legislation reflects the minority-within-majority's predicted political advantage. Hence, the procedural check remains most imperfect, because the outside minority will be disadvantaged in the legislative battle.

A procedural check also does not operate in the implicit contest of cohesive minorities against rationally ignorant and unorganized majorities. The occupational group that achieves legislative protection against the new, lower-cost producers has used the political process to restrict supply and, thus, to redistribute income (at some cost of efficiency in terms of deadweight loss) from the larger majority (as well as from the new entrants) to itself. More importantly, where the configuration of interests places a minority nested within the majority against the majority, the minority usually wins, as the example of pork-barrel rivers-and-harbors legislation indicates.

Concerning judicial control of the states' political branches, for example, the Supreme Court's recent decisions have substantially diminished the temporizing effects of virtual representation through the operation of the dormant commerce clause, the privileges and immunities clause, and the equal protection clause. The Court ordi-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

narily will strike down state legislation that facially discriminates against foreign corporations[13] and sometimes against residents of other states (see, e.g., *Supreme Court of New Hampshire v. Piper*, 470 U.S. 274 [1985]). But where the discrimination takes the form of incidence only—where it is not wholly facial—the Court tends to let the state legislation stand. Sometimes the discriminatory legislation reflects the political influence of a minority within the state (see, e.g., *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 [1978]) and sometimes the operation of the majority of the legislature against all those beyond its borders (states may be small enough, in terms of resolving a majority's free-rider problem of political organization, to bring forth such out-of-state, minority-disadvantaging legislation, even when not called for by a minority within the state nested within the majority.)[14]

The Framers fully understood these possibilities. In *Federalist* No. 10, Madison plainly grasped the political possibilities:

> The most common and durable source of factions has been the various and unequal distribution of property. Those who hold, and those who are without property, have ever formed distinct interests in society. Those who are creditors, and those who are debtors, fall under a like discrimination. A landed interest, a manufacturing interest, a mercantile interest, with many lesser interests, grow up of necessity in civilized nations, and divide them into different classes, actuated by different sentiments and views.

But just as the Framers faced uncertainty about future preferences and relative prices concerning the structuring of legislative procedures for managerial purposes (but with some policy consequences in mind), they also faced uncertainty about the structure of preferences between majorities and minorities ("factions" in Madison's "extended republic"). This uncertainty seems especially pronounced in the case of state governments, about whose legislative and electoral procedures the original Constitution remained largely silent. Concerning both federal and state political branches, however, no one could predict how future interests might align themselves or what those interests might entail. All that remained certain was that these factions would emerge and that their political actions might place both the majority and unknown minorities at a disadvantage. As Madison notes in *Federalist* No. 62:

[13]See, for example, Maryland v. Louisiana, 451 U.S. 725 (1981), and Metropolitan Life Insurance Co. v. Ward, 470 U.S. 869 (1985); but cf. Western and Southwestern Life Ins. Co. v. State Board of Equalization, 451 U.S. 648 (1981).

[14]See, for example, Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981); but cf. Kassel v. Consolidated Freightways Corp., 450 U.S. 662 (1981).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

> Every new regulation concerning commerce or revenue, or in any manner affecting the value of the different species of property, presents a new harvest to those who watch the change, and can trace its consequences; a harvest, reared not by themselves, but by the toils and cares of the great body of their fellow citizens. This is a state of things in which it may be said with some truth that the laws are made for the *few*, not for the many.

In sum, procedural guarantees cannot alone prevent a majority legislative coalition from placing a minority at a disadvantage or prevent a minority from placing either another minority or the majority at a disadvantage. As Ely correctly observes, the Framers of the Constitution, the Bill of Rights, and the Civil War Amendments anticipated that both majorities and minorities within majorities would try to sequester some minorities away from the political process. But they also anticipated that majorities, minorities within majorities, and sometimes minorities alone would try to use the political process to gain benefits for themselves and impose costs on both majorities and other minorities.

Again, we might argue, as some interpretivists seem to imply, that the Framers could anticipate the exact form of such private interest legislation and prevent it through procedural (managerial) aspects of the Constitution. But uncertainty characterizes this problem in constitution-writing as much as it does the problem of creating legislative managerial processes. The uncertainty of substance, however, grows out of two sources. First, the political process is highly entrepreneurial. One cannot predict the substantive course of legislation, because the interest groups that may arise in different circumstances remain unpredictable.[15] One even discovers in modern democracies that legislators pass laws that enable certain interest groups to arise against both majority and minority interests, in the face of an otherwise disabling free-rider problem (Berry 1977).

Second, even if one could predict the formation of particular interest groups, it is doubtful that one could predict the legislation-passing coalitions representing such groups that might form in the political branches. This problem grows out of the inherent instability of public policy decisions in majority-rule institutions. Legislators face games with no apparent equilibria; therefore, there is little theory with the power to predict the outcomes of these games and less confidence that constitution writers, even very wise ones, could foresee the nature of the coalitions or public policies that might emerge from these institutions (Riker and Weingast 1986). But our very wise con-

[15]See Hayek (1944) and Leoni (1971). I have expanded on this theme in Aranson (1987).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

stitution writers could foresee the essentially redistributive nature of much legislation.

In the face of uncertainty about future legislative substance, the Framers attacked the substantive, or value, problem in two ways. First, in Article I, section 8, they delimited the scope of congressional enactments to set tasks, thus creating a national government of "enumerated powers," which look surprisingly like the desirable subjects for public policy listed in a modern public finance text. Second, they limited the powers of both federal and state governments by restricting national coalitions of some states against others. For example, Article I, section 9 requires uniformity among states in matters of taxation (but cf. *United States v. Ptasynski*, 462 U.S. 74 [1983]), prohibits the taxation of exports from any state, and provides for neutrality among states in the "regulation of commerce." Third, the Framers' immediate successors tried to prevent federal deprivations of citizens' economic, civil, and religious rights by ratifying the Bill of Rights, as the Framers had done at the state level through the contracts and interstate commerce clauses. Finally, the drafters of the Fourteenth Amendment tried to apply those same substantive limitations of the Bill of Rights to state legislation.

If Ely is correct that the Constitution calls on the courts to "clear the channels" of the democratic process so that the preferences of all groups may register therein, and if what he calls "procedural" values are part of the judiciary's list of protected values, then what about property? Notice that the Constitution protects property against governmental incursions in the most general sense. The Fifth Amendment announces that no person may "be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation." Article I, section 9 reads: "No state shall . . . pass any law impairing the obligation of contracts." And the Ninth Amendment demands that "the enumeration in the Constitution of certain rights, shall not be construed to deny or disparage others retained by the people."

These provisions construct the broadest imaginable protections of private property. Placed in the context of a national government of enumerated powers along with the enshrinement of the common law in the Seventh Amendment, they protect the three necessary characteristics of a system of private property: universality, excludability, and transferability. Considering the very broad tendencies of federal and state political branches to erode the rights on which these characteristics rely, it seems beyond *peradventure* that the Framers intended the Constitution to be read narrowly with respect to the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

privileges of the political branches and broadly with respect to individual economic rights.

Some Cases

Most constitutional protections of property rights have not survived the Constitution's two centuries. For example, the Court's refusal to interpret exactly what a "taking" might be has narrowed the Fifth Amendment's protection of property beyond all recognition.[16] Its "public use" provision has been emptied of all meaning by a series of decisions culminating in *Hawaii Housing Authority v. Midkiff* (467 U.S. 229 [1983]). The contracts clause has gone to the same trash bin with decisions such as *Home Building and Loan Association v. Blaisdell.*[17] And the commerce clause has been gutted, as we mentioned earlier.

What about more recent cases? Economic regulation cases involving citizens' suits against a state government and its agents provide the best frame of reference for comparing Attorney General Meese's view of interpretivism with my own. This comparison seems especially noteworthy in cases involving interstate commerce, where a firm or citizen of one state finds his rights (under the commerce clause, the privileges and immunities clause, or the equal protection clause) denied by the political branches or courts of another state. Here we come up against Meese's recent list of approved and scorned decisions, of which we shall review two, beginning with *Supreme Court of New Hampshire v. Piper* (470 U.S. 274 [1985]), overturning

[16]See, for example, Epstein (1982, 1985). One need not take Epstein's extreme view of the imperatives of the takings clause (though I am inclined to do so) to understand that the Supreme Court has bent over backwards to avoid making definitive judgments that seriously limit the states' power of eminent domain. See Penn Central Transportation Co. v. New York City, 438 U.S. 104 (1978), Agins v. City of Tiburon, 447 U.S. 255 (1980), and Keystone Bituminous Coal Ass'n v. DeBenedictis, 55 L.W. 4326 (1987).

The Court's two most recent takings decisions, First English Evangelical Lutheran Church of Glendale v. County of Los Angeles, 55 L.W. 4781 (1987) and Nollan v. California Coastal Comm'n, 55 L.W. 5145 (1987), were decided in the right direction, but they are not as potent against takings as some believe. *First English* only decided the question of remedy favorably for owners in "temporary" takings. But the Court remanded the case to the trial court, to decide if a taking actually had occurred. *Nollan* held that a building permit pursuant to a land use regulation could not be used to effect an actual taking unrelated to the purpose of the permit. But *Nollan* then left in place, and indeed may have strengthened, the ability of state and local governments to accomplish regulatory takings, as in *Penn Central, Agins,* and *Keystone Bituminous.* For a discussion of the Court's many problems with takings jurisprudence, see Krier (1982).

[17]290 U.S. 398 (1934). See Epstein (1984).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the exclusion of nonresidents from membership in the New Hampshire Bar.[18]

Kathryn Piper submitted a statement of intent to become a New Hampshire resident at the time that she applied to take the New Hampshire Bar examination. She passed the examination and was found to be of good moral character. All was in order except for her resident status. Piper, who lived "about 400 yards from the New Hampshire border (470 U.S. at 275)," sought an exemption to Rule 42 of the New Hampshire Supreme Court requiring that a person be "a bona fide resident of the State . . . at the time that the oath of office . . . is administered."[19] Piper stated that "her house in Vermont was secured by a mortgage with a favorable interest rate, and [that] she and her husband recently had become parents" (id. at 276). On denial of her request by the clerk of the court, Piper formally petitioned the New Hampshire Supreme Court for an exception to Rule 42. That court denied her petition, and she filed an action in the United States District Court for the District of New Hampshire, asserting, *inter alia*, that Rule 42 violated her rights under the privileges and immunities clause of the United States Constitution, Article IV, section 2. The District Court granted Piper summary judgment (539 F. Supp. 1064 [1982]), and the Court of Appeals for the First Circuit split evenly, thus affirming the judgment below (723 F. 2d 110 [1983]). The Supreme Court then sustained the courts below, with six justices

[18]Attorney General Meese (1986, pp. 4-5) disapproved of this decision, noting:

> The *Constitutional status of the States further suffered as the Court [in its 1984 term]* curbed state power to regulate the economy, notably the professions. . . . In *Supreme Court of New Hampshire v. Piper* . . . the Court held that the Privileges and Immunities Clause of Article IV barred New Hampshire from completely excluding a nonresident from admission to its bar. With the apparent policy objective of creating unfettered national markets for occupations before its eyes, the Court unleashed Article IV against any State preferences for residents involving the professions or service industries. . . . Our view is that federalism is one of the most basic principles of our Constitution. By allowing the States sovereignty sufficient to govern, we better secure our ultimate goal of political liberty through decentralized governments.

Piper and *Metropolitan Life*, the second of the cases considered here, find the court correct on the merits, because both cases involve facial discrimination against foreign producers. See *supra*, notes 13–14 and accompanying text. In my discussion of these two cases, I focus on questions of economic rights because they help to illumine many of the issues discussed in this paper. But I also wish to record my profound disagreement with the attorney general's characterizations and interpretations of cases involving civil rights and civil liberties, including the search and seizure cases and the establishment clause religion cases. Most of the argument advanced here goes forward to these other areas of constitutional law with few modifications.

[19]470 U.S. at 277 n. 1 (affidavit of John W. King, App. 32). Surprisingly, a resident member of the New Hampshire Bar may move out of New Hampshire but still retain his membership in the Bar. Id. at 285 n. 19.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

joining Justice Powell's opinion, Justice White concurring, and Justice Rehnquist dissenting.

Public choice scholars will recognize that Rule 42 attempts to limit entry into the legal marketplace. In terms of our earlier analysis, the New Hampshire Bar is a minority nested in the majority of New Hampshire citizens. Kathryn Piper represents a minority beyond the state's representational, political institutions–in this instance, the New Hampshire Supreme Court. By restricting entry, Rule 42 harmed Piper and her class and redistributed wealth from the majority of New Hampshire's citizens to the pockets of that state's attorneys. The essential public policy argument concerned whether there were external benefits from requiring New Hampshire lawyers to be residents or alternatively whether there would be external costs from allowing lawyers practicing in New Hampshire to live elsewhere. But it is not these matters that directly concern us here; it is the Court's disposition, and the reasons for that disposition, of the constitutional rights that Piper asserted.

Justice Powell's decision found, first, that the "right to practice law is protected by the Privileges and Immunities Clause" (470 U.S. at 283). Second, he went on to explore if the state had "a substantial reason for the difference in treatment" between residents and nonresidents and if "the discrimination practiced against nonresidents bears a substantial relationship to the State's objectives" (id. at 284). Powell found that New Hampshire had no justifiable reasons for discriminatory treatment. Moreover, the majority opinion held, the state could have fashioned "less restrictive means" to accomplish its goals (id. at 284–87). Concurring in the result (id. at 288–89), Justice White held that the application of Rule 42 to Piper was invalid but that the Court need not overturn the rule itself.

Justice Rehnquist, in his dissenting opinion (id. at 289–97), argued that there are essential differences between the practice of law and the plying of other trades, which give New Hampshire a legitimate state interest in providing an adequate supply of resident lawyers. He placed much greater weight on New Hampshire's substantive claims than did the majority and said of the majority's speculations:

> It is no answer to these arguments that many lawyers simply will not perform these functions [for example, pro bono work], or that out-of-state lawyers can perform them equally well, or that the State can devise less restrictive alternatives for accomplishing these goals. Conclusory second-guessing of difficult legislative decisions, such as the Court resorts to today, is not an attractive way for federal courts to engage in judicial review. . . . I find the Court's "less restrictive means" analysis both ill-advised and potentially unman-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

> ageable. . . . [T]he challenge of a "less restrictive means" should be overcome if merely a legitimate reason exists for not pursuing that path. And in any event courts should not play the game that the Court has played here—independently scrutinizing each asserted state interest to see if it could devise a better way than the State to accomplish that goal.[20]

Justice Rehnquist's dissent is fully consistent with Attorney General Meese's preference for state sovereignty over federal *judicial* intervention. And despite the backdrop of privileges-and-immunities case law, it seems difficult to fault Rehnquist for chiding the Court on its willingness to act as a super-legislature. Thus, *Piper* appears to be yet another case where the federal government has subverted the plain meaning of the Tenth Amendment.

But Rehnquist's is a crabbed view of *Piper* and related cases. What is at issue is a claim by a citizen of one state that the government of another state has denied her rights under the privileges and immunities clause. On this reading, it is not the *result* in *Piper* that is at fault. As Justice Rehnquist points out, it is the Court's *reasoning* that seems faulty. Quoting from *Baldwin v. Montana Fish and Game Comm'n* (436 U.S. at 383 [1978]), Justice Powell wrote "that it is '[o]nly with respect to those "privileges and immunities" bearing on the vitality of the nation as a single entity' that a State must accord residents and nonresidents equal treatment" (470 U.S. at 279).

But one searches the privileges and immunities clause in vain to find such a gloss. Here is a constitutional right that is evident on its

[20]Id. at 294-95. In attacking the decision in *Piper,* Justice Rehnquist engaged in just the sort of social or economic calculation that he believes belongs in the hands of the state legislatures and that the Court should not second-guess. But in doing so, he employed arguments that are at once incorrect and fully destructive of his more basic claims. At one point, for example, he asserts (id. at 292):

> Since at any time within a State there is only enough legal work to support a certain number of lawyers, each out-of-state lawyer who is allowed to practice necessarily takes legal work that could support an in-state lawyer, who would otherwise be available to perform various functions that a State has an interest in promoting.

In a footnote to this passage, he goes on to explain (id. at 293 n. 3):

> In New Hampshire's case, lawyers living 40 miles from the state border in Boston could easily devote part of their practice to New Hampshire clients. If this occurred a significant amount of New Hampshire legal work might end up in Boston, along with lawyers who might otherwise reside in New Hampshire.

This set of claims seems astonishing on its face. Justice Rehnquist essentially is arguing that the entry of more (out-of-state) attorneys into New Hampshire practice would have no effect on price and, therefore, on quantity of legal services demanded. More important for our purposes, he has set the groundwork for the counter-argument: that the people of New Hampshire should be free to choose higher quality or lower cost substitutes domiciled elsewhere. If they willingly would not so choose, then Rule 42 is unnecessary; if they would so choose, then Rule 42 is adverse to the interests of the majority, not to mention those of Kathryn Piper.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

face: "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States. . . ." Justice Rehnquist, then, roasted Justice Powell and the Court on an extra-constitutional spit of their own making. Yet, Justice Rehnquist's substantive reasoning in *Piper* seems as inapposite as does the majority's less-restrictive-means analysis.[21] As an interpretivist (but one whose interpretations differ fundamentally from those of the present attorney general and chief justice), I read the result in *Piper* to accord with the privileges and immunities clause's iron-clad constitutional guarantee, one that seems far more evident in its application here than does the Tenth Amendment's division of powers between the state and federal governments. The action in *Piper* was brought by a citizen against a state, not by the federal government. Hence, the privileges and immunities clause should control, and it should do so absolutely.

Next in Attorney General Meese's list of disfavored decisions is *Metropolitan Life Insurance Co. v. Ward* (470 U.S. 869 [1985]). Finding a violation of the equal protection clause of the Fourteenth Amendment, the Court overturned an Alabama statute that facially imposed a higher tax on premiums received by foreign (out-of-state) insurance companies than by domestic companies. The statute also forgave some of the difference in tax rates if a foreign corporation invested up to 10 percent of its total assets in Alabama.

Public choice scholars again will recognize in *Metropolitan Life* the same pattern of rent-seeking found in *Piper*. And again, the case presents the problem of a minority nested within a majority (Alabama's domestic insurance industry) benefiting from state legislation that distributes income from all other citizens of Alabama (the majority) and from foreign corporations (the minority without representation) to itself. Of course, the foreign firms' reduction in taxes pursuant to investments made in Alabama arguably also benefits the majority of Alabama's citizens, but it does so to the detriment of the foreign minority, which has had its investment decisions altered and distorted by the law.

[21]Justice Rehnquist's dissent in *Piper* invokes the same kinds of substantive tests for state interest that the majority relies on. Neither his nor the majority's use of such speculations makes all that much sense, provided that one regards economic rights as being as fundamental and as deserving of protection as are any other rights guaranteed under the Constitution. Were his position to prevail, the Court would have engaged in "conclusory second guessing" of the Fourteenth Amendment's express language. The problem, of course, is that through the years the Court has read into the Constitution a diminished concern for economic rights. See, for example, New Orleans v. Dukes, 427 U.S. 303-4 (1976).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Metropolitan Life contains two interesting peculiarities. First, appellants sued under the equal protection clause, because the McCarran-Ferguson Act exempts state regulation and taxation of insurance companies from commerce-clause (and anti-trust) attack and because the Court earlier had removed privileges-and-immunities clause protection from corporations, holding that they are not "citizens" within the language of that clause.[22] Second, during the appeals process in the Alabama courts, to expedite disposition of their suit the appellants had waived a hearing on the issue of whether or not the statutory classification "bore a rational relationship to the purpose found by the Circuit Court to be legitimate" (id. at 874). Hence, they asked the Supreme Court to decide only if these purposes alone were legitimate or constitutionally infirm. The case thus came on appeal shorn of the opportunity for the Court to exercise its proclivities for various balancing tests: plaintiffs merely asked the Court to decide whether or not the state's purposes were legitimate against an equal-protection clause challenge.

The Court, per Justice Powell, held that this form of discriminatory taxation to advance either of the state's purposes—encouraging the development of the domestic insurance industry and encouraging investment of capital in Alabama—impermissibly denied appellants their equal protection of the law, as guaranteed by the Fourteenth Amendment. The Court's decision is the soul of brevity, compared to those in earlier cases involving taxation of foreign corporations. The Court merely distinguished some earlier cases and acknowledged the rent-seeking aspects of the "parochial" interests involved. It also appeared to eschew tiresome comparisons of the equities as well as the derogations of rights that such comparisons often invite by observing (id. at 882, footnote omitted):

> Acceptance of its contention that promotion of domestic industry is always a legitimate state purpose under equal protection analysis would eviscerate the Equal Protection Clause in this context. A State's natural inclination frequently would be to prefer domestic business over foreign. If we accept the State's view here, then any discriminatory tax would be valid if the State could show it reasonably was intended to benefit domestic business. A discriminatory tax would stand or fall depending primarily on how a State framed its purpose—as benefiting one group or as harming another. This is a distinction without a difference.

The dissenting opinion (id. at 883–902), written by Justice O'Connor and joined by Justices Brennan, Marshall, and Rehnquist, pro-

[22]Metropolitan Life Insurance Co. v. Ward, 470 U.S. 869 at 884 (1985) (O'Connor, J., dissenting) (citing Hemphill v. Orloff, 277 U.S. 537 [1928]).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

duced the usual brief of those who would support state domination of economic regulation to the exclusion of citizens' constitutional guarantees. Justice O'Connor (id. at 844) wrote, "Our precedents impose a heavy burden on those who challenge local economic regulation solely on Equal Protection Clause grounds. In this context, our long-established jurisprudence requires us to defer to a legislature's judgment if the classification is rationally related to a legitimate state purpose."

In Justice O'Connor's view, the state's purposes were legitimate by default, because such a statutory classification "trammels" not on "fundamental personal rights" nor is it "drawn upon inherently suspect distinctions such as race, religion, or alienage. . . ." Therefore, the Court's decisions in such lesser economic matters "presume the constitutionality of the statutory discrimination."[23] The classification is also rationally related to this "legitimate" state interest. For example:

> Alabama claims that its insurance tax, in addition to raising revenue and promoting investment, promotes the formation of new domestic insurance companies and enables them to compete with the many large multistate insurers that currently occupy 75% to 85% of the Alabama insurance market. Economic studies submitted by the State document differences between the two classes of insurers that are directly relevant to the well-being of Alabama's citizens. Foreign insurers typically concentrate on affluent, high volume urban markets and offer standardized national policies. In contrast, domestic insurers . . . are more likely to serve Alabama's rural areas, and to write low-cost industrial and burial policies not offered by the larger national companies. Alabama argues persuasively that it can more readily regulate domestic insurers and more effectively safeguard their solvency than that of insurers domiciled . . . in other states.[24]

And then comes the now-expected passage from *New Orleans v. Dukes:*

[23]Id. at 885 (quoting New Orleans v. Dukes, 427 U.S. 297, 303 [1976], and citing Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356 [1973]).

[24]Id. at 887-88 (citations and footnotes omitted). Justice O'Connor's economics in *Metropolitan Life* are as problematic as Justice Rehnquist's reasoning in *Piper*. First, the differential tax may not increase the number of domestic firms writing the kinds of insurance that she enumerates. Foreign firms reportedly already had abandoned this market to locals (id. at 887 n. 1), and local firms probably are at a competitive supply equilibrium. Second, the out-of-state firms might write lower-value insurance if their costs, including the tax, were smaller. Third, because foreign insurance companies write 75 percent to 85 percent of the policies in Alabama, the differential tax also redistributes income and wealth within the state from urban to rural areas, under the facts as given.

Discerning tax incidence is always a difficult problem (see, for example, McLure 1982), but the majority in *Metropolitan Life* has been properly attentive to doctrinal imperatives.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

> the judiciary may not sit as a super-legislature to judge the wisdom or desirability of legislative policy determinations made in areas that neither affect fundamental rights nor proceed along suspect lines; in the local economic sphere, it is only the invidious discrimination, the wholly arbitrary act, which cannot stand consistently with the Fourteenth Amendment.[25]

But sitting "as a super-legislature" is exactly what the dissenting opinion in *Metropolitan Life* would have the Court do. Notice that the pertinent section of the Fourteenth Amendment simply reads: "No State . . . shall deny to any person within its jurisdiction the equal protection of the laws." There is no language about "invidious discrimination" or "fundamental rights" as distinct from rights that are in some sense "less fundamental" and therefore may be read out of the Constitution when they collide with "legitimate" state interests served through "rationally related" means. Again, as in Justice Rehnquist's dissent in *Piper*, the dissenters in *Metropolitan Life* ask the Court to sit as a super-legislature, a new constitutional convention, departing from the Constitution's express language and reverting to faulty economic reasoning. Stated differently, Justice O'Connor departs from the interpretivist fold, and by implication, so does Attorney General Meese.

Meese reasons in these cases that the Constitution limits the federal government *and its judiciary* in economic jurisprudence to do only what Article I, section 8 requires. All other powers remain with the states. Hence, in his view the decisions in *Piper* and *Metropolitan Life* remain unprincipled. Of course, we search with little success to find the specific, interpretivist application of this principle to the federal judiciary. The line of reasoning pressed in these pages concerning constitutional imperatives regarding rent-seeking and uncertainty, not to mention that concerning a purified interpretivist jurisprudence based on doctrine, urges another interpretation.

One might agree with the attorney general that when the contest is just between the federal judiciary (upholding the Congress) and a state government *and its citizens*, then we would prefer state supremacy.[26] But cases such as *Piper* and *Metropolitan Life* involve much

[25]470 U.S. at 901–2 (O'Connor, J., dissenting) (quoting New Orleans v. Dukes, 427 U.S. 303–4 [1976]).

[26]One such instance arises in Garcia v. San Antonio Metro., 469 U.S. 528 (1985), which overturned the Court's exemption of municipalities from the Fair Labor Standards Act, as granted on Tenth Amendment grounds in National League of Cities v. Usery, 426 U.S. 833 (1976). While both *Garcia* and *National League of Cities* are difficult cases, I concur with Attorney General Meese's opinion that in *Garcia* the Court ignored the constitutional requirements of state sovereignty.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

more: They find the states' political branches in constitutionally impermissible rent-seeking moves that disadvantage out-of-state minorities and their own citizens as well. In most of these cases, there is also a demonstrable absence of a relationship between the legislation's stated purposes and the statutory means employed to achieve them. More importantly, there is only one clear motive for such moves: to deprive the unrepresented of the opportunity to enter commerce in the protectionist, mercantile state.

Constitutional Correctives

A growing number of legal commentators, economists, and political scientists have become increasingly dissatisfied with the (in)ability of contemporary constitutional argument to suppress the rent-seeking, rights-degrading activities of the political branches (Aranson 1985). I have sought to outline the reasons for believing that doctrinal constitutional argument—a reliance on the Constitution's evident value-based constraints on the political branches—exercised by a reinvigorated judiciary should provide a welcome source of suppression. But a widely accepted judicial method for providing that source is not close at hand.

We enjoy only one positive economic theory of judicial review of legislative enactments: that developed by Landes and Posner (1975). Their theory explains that the legislature gives independence to the judiciary in exchange for which the judiciary refrains from judicial review of legislation on *legislative* (value) grounds. The purpose of this bargain, at least in the minds of legislators, is to enhance the durability of special interest legislation. The judiciary (I would claim, though Landes and Posner do not) may review legislation on grounds orthogonal to legislative concerns (for example, on procedural grounds such as the requirements of separation of powers), but it agrees not to replace legislative policy values with its own. In all other instances the judiciary must defend bargains struck in the legislature (to avoid an end-run around the lawmaking process by dissatisfied lawmakers or interest groups) and avoid declaring an act of Congress unconstitutional.

As a *positive* theory, the Landes and Posner theory has several problems. First, it fails to acknowledge that the judiciary remains sufficiently decentralized so that individual federal judges may "chisel" on the implicit bargain. Second, the theory does not explain why or ask whether the federal judiciary would stay its hand from invalidating state legislation on constitutional grounds. Indeed, the federal judiciary sometimes does overturn state legislation on precisely such

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

grounds. Third, most acts of Congress filter through a bureau or agency in the implementation process, and review of administrative actions thus remains an indirect but potent source for judicial control of the political branches. Fourth, Landes and Posner support their theory with the common observation that the Supreme Court seldom has invalidated congressional enactments on constitutional grounds. But that evidence (gathered before *I.N.S. v. Chadha,* 462 U.S. 919 [1983]) may indicate simply that the members of Congress anticipate invalidation and structure their enactments to avoid it.

Beyond this single positive theory, the legal literature contains several normative theories of how to engage the judiciary as a counterforce to rent-seeking and sometimes to the derogation of constitutional rights. Judge Easterbrook (1984), for example, would have the Court be a faithful agent of the legislature in enforcing any interest-group bargains that it reviews; but he would have the Court enforce such bargains narrowly, using the old doctrine that statutes in derogation of the common law should be strictly construed. The parties to the bargain should get what was enacted, no more and no less. Over time the existence of legislatively created rents will attract legally differentiated competitors and others beyond the statute's narrowed domain, who will help to dissipate any rents created.

For the most part, Professor Ely would use the judiciary to open up the political process, allowing the courts to make value judgments only when the legislature, to the detriment of a minority, is structurally and preferentially incapable of doing so. But Ely's gloss turns out to be a valiant yet ultimately unsuccessful attempt to read substantive values as procedural rights, and one that does nothing to protect unorganized majorities.

Unlike Judge Easterbrook, Jonathan Macey (1986) argues that the Court, in following its traditional approach to statutory interpretation, should not look for interest-group bargains, but instead should assume that each enactment has a benevolent public purpose, as stated in its preamble or as assumed to be the product of "reasonable men." The Court should then interpret the statute accordingly. In Macey's view, "where [there is] a sharp divergence between the stated public-regarding purpose of the legislature and the true special interest motivation behind a particular statute, courts will, under the traditional approach, resolve any ambiguities in the statute consistently with the stated public-regarding purpose" (p. 251). But this approach borders on substantive review.

Gellhorn, Robinson, and I (1982) have argued (as do Ely 1980 and Sunstein 1985) that the Court should pay attention to procedure and reinvigorate the delegation doctrine, to reduce the use of regulation

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

for redistributive purposes. Our theory urges the courts to require legislative specificity, *inter alia,* to place the full political costs of its actions on the legislature, which it now escapes through delegating legislative tasks to bureaus and agencies.

Each of these proposals has some merit, though at least two of them (Easterbrook's and Macey's) contradict each other. The essential problem that all share, however, is a full reliance on process, a venerable legal fallback. Each, of course, is but an unsatisfactory substitute for substantive due process, a doctrine long held in disrepute. But though process standards may seem value-neutral—and, therefore, constitutionally principled answers to the dilemma of judicial review in a democracy—social choice theory demonstrates that they never can be so. Moreover, clever people can invent a hundred different ways to circumvent procedural guarantees, so that over time such guarantees will grow increasingly obsolete and only their managerial functions will remain.

Since the end of the *Lochner* era, the closest one comes to finding a frontal attack on rent-seeking is in the writings of Mashaw (1980) and Sunstein (1984, 1985). But even these scholars take an oblique approach to the problem, arguing for methods of review that ultimately turn aside from a direct constitutional attack on rent-seeking.

The burden of the argument in these pages, then, is that the Framers endowed the Constitution and its amendments with both process and value limitations on the political branches. The Court has upheld both kinds of limitations, but it has withdrawn from imposing most value limitations in economic litigation (though not yet fully in the area of civil rights and liberties). The time has come for the Court to recognize the Constitution's full protection of economic liberties (Epstein 1982, 1984, 1985; Siegan 1980). And as we grow increasingly dissatisfied with the limited protections that procedure alone can afford—special interests, which have solved the rational ignorance problem, will dominate *any* process that courts might impose except a random and constantly changing one—we might rediscover the full meaning and intent of the great clauses of the Constitution that the Framers designed explicitly to protect economic liberties against federal and state intervention.

References

Aranson, Peter H. "Judicial Control of the Political Branches: Public Purpose and Public Law." *Cato Journal* 4 (Winter 1985): 719–82.

Aranson, Peter H. "Calculus and Consent." In *Democracy and Public Choice,* pp. 60–65. Edited by Charles K. Rowley. New York: Basil Blackwell, 1987.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Aranson, Peter H.; Gellhorn, Ernest; and Robinson, Glen O. "A Theory of Legislative Delegation." *Cornell Law Review* 68 (November 1982): 1–67.

Aranson, Peter H., and Ordeshook, Peter C. "Public Interest, Private Interest, and the Democratic Polity." In *The Democratic State*, pp. 87–177. Edited by Roger Benjamin and Stephen L. Elkin. Lawrence: University Press of Kansas, 1985.

Berry, Jeffrey M. *Lobbying for the People: The Political Behavior of Public Interest Groups*. Princeton: Princeton University Press, 1977.

Brennan, Geoffrey, and Buchanan, James M. *The Reason of Rules: Constitutional Political Economy*. New York: Cambridge University Press, 1985.

Brennan, William J. Speech to the Text and Teaching Symposium, Georgetown University, 12 October 1985. In *The Great Debate: Interpreting Our Written Constitution*, pp. 11–25. Washington, D.C.: The Federalist Society, 1986.

Buchanan, James M., and Tullock, Gordon. *The Calculus of Consent: Logical Foundations of Constitutional Democracy*. Ann Arbor: University of Michigan Press, 1962.

Buchanan, James M.; Tollison, Robert D.; and Tullock, Gordon, eds. *The Theory of the Rent-Seeking Society*. College Station: Texas A & M University Press, 1980.

Currie, David P. "Positive and Negative Constitutional Rights." *University of Chicago Law Review* 53 (Summer 1986): 964–80.

Downs, Anthony. *An Economic Theory of Democracy*. New York: Harper and Row, 1957.

Easterbrook, Frank H. "Foreword: The Court and the Economic System." *Harvard Law Review* 98 (November 1984): 4–60.

Ely, John Hart. *Democracy and Distrust: A Theory of Judicial Review*. Cambridge: Harvard University Press, 1980.

Epstein, Richard A. "Taxation, Regulation, and Confiscation." *Osgoode Hall Law Journal* 20 (September 1982): 433–53.

Epstein, Richard A. "Toward a Revitalization of the Contract Clause." *University of Chicago Law Review* 51 (Summer 1984): 703–51.

Epstein, Richard A. *Takings: Private Property and the Power of Eminent Domain*. Cambridge: Harvard University Press, 1985.

Hayek, Friedrich A. *The Road to Serfdom*. Chicago: University of Chicago Press, 1944.

Hayek, Friedrich A. *Law, Legislation, and Liberty: The Political Order of a Free People*. Vol. 3. Chicago: University of Chicago Press, 1981.

Heiner, Ronald A. "The Origins of Predictable Behavior." *American Economic Review* 73 (September 1983): 560–95.

Heiner, Ronald A. "Imperfect Decisions and the Law: On the Evolution of Legal Precedent and Rules." *Journal of Legal Studies* 15 (June 1986): 227–61.

Heiner, Ronald A. "Imperfect Decisions in Organizations: Toward a Theory of Internal Structure." *Journal of Economic Behavior and Organization* (forthcoming 1988a).

Heiner, Ronald A. "The Necessity of Imperfect Decisions." *Journal of Economic Behavior and Organization* (forthcoming 1988b).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Krier, James E. "The Regulation Machine." *Supreme Court Economic Review* 1 (1982): 1–37.

Landes, William M., and Posner, Richard A. "The Independent Judiciary in an Interest-group Perspective." *Journal of Law and Economics* 18 (December 1975): 875–901.

Leoni, Bruno. *Freedom and the Law*. Los Angeles: Nash, 1971.

Macey, Jonathan R. "Promoting Public-Regarding Legislation through Statutory Interpretation: An Interest Group Model." *Columbia Law Review* 86 (March 1986): 223–68.

Mashaw, Jerry L. "Constitutional Deregulation: Notes Toward a Public-Public Law." *Tulane Law Review* 54 (June 1980): 849–976.

Mayhew, David R. *Congress: The Electoral Connection*. New Haven: Yale University Press, 1974.

McKelvey, Richard D., and Ordeshook, Peter C. "An Experimental Study of the Effects of Procedural Rules on Committee Behavior." *Journal of Politics* 46 (February 1984): 182–205.

McLure, Charles E., Jr. "Incidence Analysis and the Supreme Court: An Examination of Four Cases from the 1980 Term." *Supreme Court Economic Review* 1 (1982): 69–112.

Meese, Edwin, III. Speech Before the American Bar Association, 9 July 1985, Washington, D.C. In *The Great Debate: Interpreting Our Written Constitution*, pp. 1-10. Washington, D.C.: The Federalist Society, 1986.

Miller, Nicholas. "Pluralism and Social Choice." *American Political Science Review* 77 (September 1983): 734–47.

Riker, William H. "Implications from the Disequilibrium of Majority Rule for the Study of Institutions." *American Political Science Review* 74 (June 1980): 432–47.

Riker, William H. *Liberalism Against Populism: A Confrontation Between the Theory of Democracy and the Theory of Social Choice*. San Francisco: W. H. Freeman, 1982a.

Riker, William H. "Democracy and Representation: A Reconciliation of *Ball v. James* and *Reynolds v. Sims*." *Supreme Court Economic Review* 1 (1982b): 39–68.

Riker, William H., and Weingast, Barry R. "Constitutional Regulation of Legislative Choice: The Political Consequences of Judicial Deference to Legislatures." Working Paper P-86-11. Stanford University, Hoover Institution, Domestic Studies Program, 1986.

Rizzo, Mario J. "Law Amid Flux: The Economics of Negligence and Strict Liability in Tort." *Journal of Legal Studies* 9 (March 1980): 291–318.

Shepsle, Kenneth A., and Weingast, Barry R. "When Do Rules of Procedure Matter?" *Journal of Politics* 46 (February 1984): 206–21.

Siegan, Bernard H. *Economic Liberties and the Constitution*. Chicago: University of Chicago Press, 1980.

Sunstein, Cass R. "Naked Preferences and the Constitution." *Columbia Law Review* 84 (November 1984): 1689–1732.

Sunstein, Cass R. "Interest Groups in American Public Law." *Stanford Law Review* 38 (November 1985): 29–87.

Weingast, Barry R.; Shepsle, Kenneth A.; and Johnsen, Christopher. "The Political Economy of Costs and Benefits: A Neoclassical Approach to Dis-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

tributive Politics." *Journal of Political Economy* 89 (August 1981): 642–64.
Williams, Stephen F. "Liberty and Property: The Problem of Government Benefits." *Journal of Legal Studies* 12 (January 1983): 3–40.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Federalism: A Market Economics Perspective

Robert L. Bish

Introduction

Two very good years were 1776 and 1787. The first of these years saw the publication of Adam Smith's *Wealth of Nations* and the Declaration of Independence, two of the most influential documents in Western thought. The second of these years saw not just the drafting of the U.S. Constitution but, even more important, the initiation of a series of essays by Alexander Hamilton, John Jay, and James Madison, which came to be known as the *Federalist*. The sense in which these essays may be considered of greater importance than the Constitution rests on the notion that how we think about complex phenomena is usually more important than some objective "truth" about that phenomena; and while any constitution will have problems over time, a way of thinking about it, which is what the *Federalist* presents, may help us find solutions.

During the past dozen years, bicentennial celebrations of Smith's *Wealth of Nations,* the Declaration of Independence, and the Constitution have been publicized extensively, but there has been very little recognition of how close intellectually the ideas in these works are. Indeed, a good case can be made that they are so complementary that an understanding of their implications can be reached only if they are examined together rather than separately. This is especially the case for understanding the *Federalist;* without some understanding of complex systems, such as markets or multi-organizational struc-

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.

The author is Professor of Public Administration and Economics at the University of Victoria. This paper has benefited from discussions with and comments by Buzz Boschken, Laura Langbein, Vincent Ostrom, Mark Sproule-Jones, and Jeffrey Wallin.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

tures, these essays do not appear to have a consistent theoretical framework.[1]

In the analyses that follow, the similarities and differences between Smith's approach to markets and social coordination will be compared with the *Federalist's* approach to government. While this method results in some obvious conclusions, they might not be so obvious without the benefit of the last 30 years of intellectual revival, which was based on self-consciously using the logic of economics for institutional analyses. Many of the conclusions of these analyses could be derived as well from the work of James Buchanan, Gordon Tullock, Mancur Olson, Vincent Ostrom, and others associated with public choice theory.

Basic Theory

All theories are abstractions, and any summary of a theory or body of related theories must be selective in features chosen for comparison. For purposes here, I will summarize a few elements of market and federalist theory, including both assumptions and generally recognized conclusions.[2]

Market Economics

Many important elements of market economics have remained unchanged since economics began to emerge as a discipline during the 18th century, including assumptions of scarcity and rational, self-interested behavior.[3] For example, in his *Wealth of Nations*, Smith

[1]An analysis of the difficulty political scientists have had in dealing with the theoretical structure of the *Federalist* is presented in Ostrom (1971). There are also political scientists who consider the *Federalist* to possess a well-integrated theoretical structure. See, for example, Ostrom's (1971) discussion and Alfred Diamond's writings. For an integrated interpretation by an organization theorist, see Boschken (1982).

[2]For a more detailed analysis, see Bish (1977).

[3]Justification of the assumption of rational behavior—that is, reasoned behavior to relate means to ends—includes its predictability and the fact that only *some* people need be rational for models to yield good predictions, in addition to the notion that survivors in a competitive system must have acted *as if* they were rational. Rational choice does not require assumptions of perfect information and equilibrium, and the rationality postulate can be applied to any situation of scarcity and choice.

The assumption of self-interested, rational behavior in a world of imperfect knowledge appears to be identical to the way Hamilton, Madison, and Jay viewed individuals and their environment. The authors of the *Federalist* also emphasized (pp. 226–30) that humans are fallible and can learn. Their conception of rational behavior does not imply a mechanistic "irrational" passion for rational calculation in a world of perfect information, nor does it imply social aggregates, such as governments. Thus, the Smithian and the *Federalist* view of man is significantly different from the view held by many contemporary economists.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

demonstrated how self-interested behavior could result in a more efficient use of scarce resources and, hence, a higher standard of living for citizens than was likely to be achieved in a society where the sovereign directed the allocation of resources.

There are both positive and normative components to Smith's argument. Normatively, the economic system was to be judged by the degree to which it resulted in citizen/consumer satisfaction, not by how well it satisfied the preferences of producers or the sovereign. In the positive or predictive argument, the division of labor was important for achieving a higher standard of living; the complexity of a system of specialized individuals and businesses was too great for the sovereign to obtain information about consumers' preferences and how to organize production. Smith anticipated that a market economy would include a great number of cooperating and competing individuals and organizations. He also was among the first to discuss a key theme in the theory of markets, namely, how social coordination can occur without central direction. Subsequently, Hayek (1945) and other economists continued to emphasize "information" as one of the most important outputs from market exchange. Furthermore, only by seeing preferences "revealed" through voluntary choices could an outside observer infer what people really want (Buchanan 1959).

Smith was also concerned with the problem of monopoly. He specifically warned that a popular use of government was merchants advocating laws that create monopolies, which in turn reduce benefits to consumers. According to Smith, all suggestions for government involvement in business should be viewed with skepticism. Smith did recognize and advocate using government to maintain the legal system and to provide military security and public works. His major concern, however, was with explaining the operation of markets, and his analysis of government consists primarily of identifying the consequences of governmental policies or recommending that the government should or should not do certain things. Smith provided no real analysis of how government could be organized so that it would be more likely to do the things he recommended rather than those he recommended against.[4]

Since Smith's *Wealth of Nations*, the dominant developments in economics, especially in the United States, have been less concerned

[4]Smith's arguments are virtually identical to those of Mancur Olson in his *Rise and Decline of Nations* (1982), which applies the logic of collective action and public goods to interest group formation and activity. Olson also lacks an answer to the dilemmas he poses.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

with information, monopoly, and social coordination. The focus has shifted to the logical development of implications of different conditions within a known environment where government was abstracted from, or treated as if it were run by a benevolent despot who would accept and implement an economist's advice. Only recently have economists extended their postulate of rational self-interest to the public sector and begun to examine the problems of information, monopoly, and social coordination in government. It is within this framework that modern economists can learn from the authors of the *Federalist*.

Federalist Theory

Scholars of federalism seem to agree less on a common paradigm than do scholars of market economics.[5] It does seem clear, however, that federalism as a system of government is viewed as a potential solution to Hobbes's problem of constraining the Leviathan, that is, of maintaining a constitutional government where government officials operate within the law and have no power to change the law to suit their own self-interest (Hobbes [1651] 1962). This normative objective is clearly set out in the Declaration of Independence and repeated throughout the *Federalist*. Contained within this analysis is the explicit assumption that people, including government officials, act in their own self-interest. Furthermore, they will use government to advance their own interests unless they are constrained by persons who have recourse to other government officials to protect them from those officials who would abuse their authority (*Federalist* No. 51). In economic terms, monopolies in government are to be avoided just as are monopolies in the market. Hobbes's problem of the Leviathan could also be labeled "a monopoly problem."

The authors of the *Federalist* also address market economics in their analysis of information problems, especially knowledge of the preferences of individuals that the government is to serve. They argue that the economy and policy are so complex that issues should be debated and scrutinized in several forums to be certain that the viewpoints from people with different information are considered before adoption (*Federalist* No. 69). They also emphasize how difficult it is for an external observer to know or understand an individual's preferences, stressing that each person is the best judge of his own self-interest but *not* possessing the capacity to judge his own

[5]My own theory of federalism and interpretation of the *Federalist* have been heavily influenced by the work of and working with Vincent Ostrom, especially *The Political Theory of a Compound Republic* (1987).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

interests in relation to the interests of others (*Federalist* No. 10). It also seems clear that the authors of the *Federalist* anticipated both cooperation and rivalry among governments (for example, rivalry with concurrent taxation and cooperation in tax administration [*Federalist* Nos. 35–36]), just as Smith recognized cooperation and competition among individuals and organizations in the market. Competition among and within governments is critical to prevent monopolization and to preserve a governmental system with an enforceable constitution. At the same time, cooperation emerges because related activities are often performed more effectively by organizations of different sizes; hence, citizens could be made better off by the same kind of specialization and trade that occurs among manufacturers, wholesalers, and retailers in the market. It is also important to recognize that in the *Federalist* (No. 36) local governments—called "the system of each state within that state"—are included as part of federalism. This inclusion is a natural additional division of labor that recognizes thousands of governments instead of just those at state and national levels. It is this vast system of governments that is viewed in the same manner that Smith viewed markets, and it is this extension of Smith's logic to the analysis of constitutions and institutions that is the critical contribution of the *Federalist* to an understanding of the problem of social coordination among governments when no single government or group is "in charge."

There is one area, however, where the authors of the *Federalist* specifically differ from at least the "laissez-faire" economists. There is nothing "automatic" about the creation of a governmental system where governments serve citizens and not themselves. In fact, even the authors of the *Federalist* viewed the creation of such a government as a rare experiment in a world populated primarily by governments whose structure was dependent on accident and force (*Federalist* No. 1).

Smith's market economics and the constitutional analysis of the *Federalist* reflect a similar way of thinking. Both view individuals in the same way, both have a similar normative perspective, and in both the issues of competition, monopoly, information, and coordination among many independent individuals and organizations are central to the analysis. These similarities indicate that further application of market economics concepts may enhance our understanding of federal systems.

Voluntary Agreements and Exchange

The market economy runs on voluntary agreements, most of which are of an exchange nature. In its simplest sense, individuals choose

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

to enter into agreements with other individuals where they perceive that they will obtain the greatest net gain. Societal coordination occurs when each person selects among substitutes, and competition stimulates individuals to be efficient and to try to offer more than their competitors. This process works best when there are many buyers and sellers, freedom of entry and exit, well-specified and enforceable property rights, and relatively high levels of information. It is important to consider whether or not we can transfer applications of the concept and conditions of exchange that lead to mutually beneficial social coordination in the use of scarce resources to a federal system.

By definition, in a federal system there are multiple individuals and organizations that need to interact with one another without central direction. In addition, this interaction occurs within a set of rules (a constitution) analogous to the rules of property that operate in markets.

So far so good. But is there anything automatic about voluntary exchanges among different components of a federal system or between citizens and different components of a federal system leading to the kind of social coordination and efficient resource usage that Smith envisaged for private markets? Is it possible that a constitution could create a federal system that resolved the Hobbesian problem, that is, could it prevent any monopoly organization from taking over the system, while failing to create a system where an individual's responses to incentives lead to lower rather than higher levels of citizen consumer satisfaction? The answer to both these questions is yes.[6] The

[6]Two important questions need to be asked to demonstrate this. First, can citizens effectively articulate their demands and be responded to; second, can citizens avoid costs imposed on themselves when benefits accrue to others? Both questions are equally important for evaluating the performance of a political system. Yes or no answers to these questions provide four potentially different situations:

		Responsive to Citizens	
		No	Yes
Citizens Can Avoid Political Externality Costs	No	Tyranny	Gargantua
	Yes	No Government	Contractarian Ideal

If a governmental system does not respond to citizens and yet citizens must pay for it, it can only be described as a tyranny. This is the kind of system the Founding Fathers wanted to avoid, and for the most part they were successful. If a government were not responsive and citizens could avoid paying for anything that did not benefit them, the result would be no government.

There are also two possibilities for responsive governments. If a government were responsive to the requests of all groups and yet citizens could avoid political externality

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

more important question is how an understanding of exchange helps us recognize how we can achieve either beneficial or perverse outcomes from the operation of a federal system.

One need look no further than Smith for an answer to how voluntary agreements can lead to poor outcomes for consumers. Smith explicitly recognizes that although competition is good for consumers, it is anathema to businessmen and that whenever possible they will collude to legally rig the market or seek monopoly status. In short, individuals and organizations are just as likely to enter into agreements with each other that disadvantage third parties as they are to enter agreements that create social well-being unless consumers always have substitute suppliers available to them. Although federalism is designed to provide "substitute" governments so that the officials of different governments or branches of a government watch each other, there is nothing intrinsic in federalism that would prevent collusion among government officials or between government officials and some citizens. In fact, because governments wield coercive power, the incentives to engage in such collusion may be even stronger than may occur among Smith's businessmen. But given the normative content of the *Federalist*, with its focus on protecting citizens against the state, is there any reason to be concerned about such collusion in the American federal system? The work of Anthony Downs, James Buchanan, Gordon Tullock, Mancur Olson, and other public choice theorists provides considerable insight into this question.

Downs, Buchanan and Tullock, and Olson all analyze situations where large numbers of people have difficulty striking mutually beneficial agreements because of high decisionmaking costs. Downs (1957) describes how politicians seeking office would seek a "median voter" position in small political units; but as the size of government increases, parties will be formed, specific information will be less

costs, those individuals and groups that benefited from governmental policies would have to pay for them. Individuals and groups would only demand programs where there were net benefits because they bear the costs. This is the system that would be expected to generate the greatest mutual benefits and could be called the contractarian ideal.

The final possibility is that government is responsive to citizens and organized groups but that other citizens cannot avoid paying the costs of the responsiveness; thus, very high political externality costs are generated. This "gargantua" outcome is most likely when political decisionmaking is primarily through bargaining among organized interests to obtain special benefits, yet costs are spread out over all citizens. In the extreme, most, if not all, citizens would find the cost of government exceeding benefits; but also know that if they give up their special benefits and others do not they will be even worse off. It is this kind of problem that may be most difficult to deal within a federal system where politicians and bureaucrats compete to be responsive.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

visible, and ideologies and appeals to special interests will emerge. Buchanan and Tullock (1962) explain how lowering decisionmaking costs with less than the unanimous support required for political decisions may result in costs being imposed on those whose consent is not needed in the decisionmaking process. Mancur Olson (1965, 1982) analyzes how special interests can come to dominate political decisionmaking.

The conclusion emerging from these analyses is that a federal system can be one where narrow interests and governments act like Smith's cartels and monopolists, except that the situation may be worse because governments have the power to regulate and to tax—powers that Smith's monopolists lacked. In addition, because of the nature of political competition in large governments, there is no reason to predict that elected officials will make mutually beneficial decisions instead of catering to special interests at some cost to citizens. This does not mean that such costs can be infinite, because citizens can "vote with their feet" (Tiebout 1956) to escape tyranny; but, as with any "monopolist," if substitutes are more costly than they would be under competitive conditions, there is some transfer of wealth from consumers and excluded suppliers to the monopolist with a net loss in the process. Voluntary agreements within and among governments can lead to both positive and negative consequences.

Bureaucratic Production and Contracting-Out

Public choice theory implies that local governments, which are relatively small, homogeneous, and have a limited range of functions, should have the fewest problems in electing politicians who represent and have incentives to respond to citizens' preferences (Bish 1971). Local governments, however, face some unique production problems, because they are either too large or too small to produce all of their activities at the lowest average cost. There is also the problem that all producing organizations face in ensuring that their managers are efficient. Local governments usually respond to scale problems by recommending that the governments be made larger to capture economies of scale and that they decentralize internally for those activities lacking economies of scale. While appearing to be based on "economic analysis," these recommendations pay no attention to whether or not the managers of the organizations (who are like Smith's businessmen) have any incentive to produce efficiently. The best empirical evidence is that they apparently do not.[7] Many

[7]For an analysis of the Reform Tradition in local government, a tradition that recommended one local government for each metropolitan area on the assumption that it would produce local services at lower cost, see Bish and Ostrom (1973).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

studies of the production of local government services indicate that after a local government makes a policy decision on what to provide to its citizens it can obtain much less costly production of the goods by contracting-out in a competitive bidding process.[8] For example, a recent study of garbage collection in all Canadian municipalities with over 10,000 in population indicates that municipally managed collection averages $42.29 per household and contracted-out collection averages $28.02 (McDavid 1985). The cost difference is a result of private contractors using large trucks with two-man crews who collect twice as many tons per man per day as do municipal crews using small trucks and three-man crews (who also spend a large proportion of the day riding back and forth to the dump). This is not unusual, as a recent survey of contracting-out in the United States and Canada indicates (Bish 1986).

Contracting-out occurs not just between local governments and the private sector but among governments as well. Robert Warren's (1964, 1966) studies of Lakewood Plan cities in California indicate that governments can compete with private sellers when they have the incentives to do so and that governments of different levels can resolve both incentive and scale problems by contracting with one another and with private firms. Contracting-out with competitive bids eliminates the monopoly position of the government bureaucracy and introduces more information and competition into the system. These changes contribute to better results for citizens, as both Smith and the *Federalist* would predict.

Government Collusion

Smith emphasizes that businessmen will form cartels that disadvantage consumers. So will government officials. One striking example of empirical research on a "cooperative agreement" among government officials is Dolores Martin's (1976) analysis of Local Agency Formation Commissions (LAFCOs) in California and similar arrangements restricting the creation of local governments in other states. LAFCOs are comprised of the representatives of existing government units that must approve new governments and government boundary changes. Many economists would argue that LAFCOs would reduce public service costs by simplifying and rationalizing the local government structure. Others would hypothesize that because they are comprised of officials of existing local governments, LAFCOs would act as a cartel would and simply exclude competition from the market, resulting in higher local government costs over time. Martin

[8]For a recent analysis of evidence on contracting-out, see Bish (1986).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

found significantly higher annual cost increases for local government after LAFCOs were created in California relative to the cost before their creation. Her nationwide, cross-sectional study also indicates that states with this kind of arrangement face significantly higher local government costs than found in non-LAFCO or "free-entry" states.

It is precisely this kind of hypothesis building and empirical testing that is critical to understanding the relationship between intergovernmental relations and outcomes in federal systems. It is also direct evidence that Smith's logic is as applicable to the public sector as it is to the private sector. There are many more examples of market-like behavior, including exchanges for mutual benefit, such as contracting-out production and collusive behavior, which impose net costs on citizens.[9] The important point here is that thinking with a market economics model helps us understand how federal systems operate.

Fiscal Federalism

Neither studies of contracting-out nor collusion among government officials would generally be considered to be studies of federal systems in the context of a body of literature generally referred to as "fiscal federalism."[10] Historically, fiscal federalism has considered tax coordination and competition; more recently, it has included grant programs and functional responsibilities for different levels of government. These later analyses have been facilitated by the theory of public goods and externalities and the recognition that most public goods and externalities affect areas smaller than the entire country. This work, however, poses interesting problems for conclusions based on market economics and the federalist models, because fiscal federalism studies arrive at conclusions that are directly contrary to conclusions based on market economics and the political theory of federalism.[11] Not only are the conclusions different, but their normative recommendations would also eliminate the most distinguishing feature of a federal system, competition among governments.

[9]For example, revenue-sharing has been viewed as a collusive agreement to raise all local government revenues while avoiding the competition that would come from "voting with one's feet" (Bish and Ostrom 1973, p. 64; McKenzie and Staaf 1978). For further analysis of governmental cooperation that benefits citizens and cooperation (collusion) that disadvantages citizens, see Bish (1978).

[10]Some of the points made in this section are treated in Bish (1977).

[11]Three significant exceptions are the work of Nathan (1975), Scott (1973), and Wagner (1971). None of them, however, directly confronts the dilemma posed by the application of public goods theory to federal systems.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

In *Fiscal Federalism,* Wallace E. Oates (1972) reaches the same conclusions as have other major economists, including Musgrave (1969), Tiebout (1961), and Head (1974). Oates presents a highly simplified and essentially normative model of the public sector: "In this pure model there is a *clear division of functions among levels of government,* one that leads to the attainment of a welfare optimum" (p. vii, emphasis added). Oates's conclusion does not follow from basic economic theory unless we are willing to assume that a monopoly behaves in the same way as does an organization where citizens have alternatives. Oates has focused only on scale problems; that is, different government activities may most efficiently be provided for different sized geographic areas or produced by different sized organizations. Oates simply ignores the monopoly problem, which is so important (and which provides the very rationale for a federal system) as presented in the *Federalist.*

Analyses of federalism that ignore the monopoly problem and focus only on scale problems are indistinguishable from analyses of decentralized unitary government systems—a point Oates (pp. 16–17) recognizes explicitly, without concern. There are, however, reasons for neglecting the monopoly problem. One could assume that public officials would not act in their self-interest and instead be benevolent monopolists, like Plato's philosopher king. I do not think that Oates intends to make that assumption, because his analysis of intergovernmental grants and taxation requires self-interested officials to respond to particular incentive systems, and they cannot all be schizophrenic. A second reason could be that electoral competition alone will keep public officials responsive, but this argument is not stated and could easily be refuted by drawing on economic analyses of the problems of managing government bureaucracies (Tullock 1965; Niskanen 1971; Ahlbrandt 1973). Thus, a critical question remains: Are Oates and other economists who study fiscal federalism logically inconsistent in their behavioral assumptions and neglectful of empirical evidence on political competition, or does the introduction of the concept of a public good really force the conclusion that a system of monopolies producing public goods on an appropriate scale is superior to a federal system characterized by competition among governments that provide substitutes for one another? Were Smith, the Framers of the Constitution, and the authors of the *Federalist* that wrong? Or do serious problems exist in "fiscal federalism"?

Public Goods Theory and Federalism

Public goods are defined as goods, services, or valued states of affairs that when once provided no one can be excluded from bene-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

fiting (nonexclusion) and no one's consumption reduces another person's consumption (nonsubtractability). The nonexclusion characteristic generates a free-rider problem; that is, voluntary contributions will not support provision because noncontributors cannot be excluded from benefits. Public goods are predicted to remain unprovided (or underprovided) in a purely market economy. The solution to the free-rider problem is through coercive taxation, where all beneficiaries are forced to pay, with the power to tax being a general characteristic of government. If a public good is pure—that is, if the characteristics of nonexclusion and nonsubtractability are extended nationwide—then the potential low-cost provision system, *ceterus paribus*, would be a single governmental unit. By adding different kinds of "impurities," such as geographically confined benefits or geographic differences in people's preferences, one can develop arguments for provision by smaller governmental units.

What is being discussed here is provision, that is, demand articulation and collection of taxes, not actual production. Production may be undertaken by an organization either larger or smaller than the government that provides the service through intergovernmental agreements and contracting. Some economists have assumed that provision and production are undertaken only by the same organization; thus, they have combined the economies-of-scale criterion with the provision criteria to determine the variety of optimal-sized governments in a system (Rothenberg 1970). This reasoning process is equally appropriate for either decentralized unitary or federal governments.

But does this logic lead to the conclusion that different public functions should be provided exclusively by different levels of government? What constitutes the "public good" here is critical. For example, if public safety means providing a night watchman, a small government may be efficient. If public safety means capturing bank robbers, then a large organization—or at least one covering a larger geographic area—may be more efficient. If public safety means bringing criminals to trial, a prosecutor and a court system may be appropriate. If public safety consists of all of these elements, then the function may be best provided by multiple governments at the same time. Just what is the public good? If we apply our definition of public good only to single activities—for example, the patrol by the night watchman—and not to groups of activities constituting functions, we can conclude that a single organization should provide a single activity within its area of benefits. This approach is consistent with a logic of different activities for different levels of government and is implicit in the work of Head (1974), Tiebout (1961), and

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Musgrave (1969). It is also consistent with Oates if we assume that his terms, services, activities, functions, and programs describe only single activities. From this, Oates concludes that an economist's theoretical model should indicate a clear division of functions but that the "real world" appears to be one of increasing participation of different levels of government providing the same functions. If Oates had applied his public goods theory to only specific activities and recognized that different activities comprising the same function could be undertaken by different levels of government, his ideal model would be consistent with observed trends in multilevel fiscal activity and permit him to go much further in analyzing federal systems than he has been able to do. He could also avoid trying to justify an ideal type that obviously does not fit. In addition, it is precisely the observation that different activities of functions may be provided by different levels of government that makes a solution to the monopoly problem—which Oates totally neglects—possible in federal systems.

Public Goods and Monopoly

The logic of a public good is such that provision by a single organization in an area is most efficient. If there are multiple organizations, then it is rational for each to let others provide the good; members of the nonproviding organization may then consume the good without having contributed to its cost. When there are multiple organizations, some organizations will be free-riders.

The logic that a single organization is needed for a public good poses a monopoly problem: if the officers of the organization do not efficiently provide the public good to meet citizens' preferences, the citizens have no substitutes to turn to. For example, if one organization provides all public safety activities and its officers harass citizens when they call for help, there is no other source of assistance, including protection from harassment by the officials themselves. In contrast, even if patrolling activities are provided by a single law enforcement agency, if other public safety activities are provided by employees of other organizations (such as sheriffs, federal marshals, state patrols, prosecutors, and the FBI), then there are substitutes; if local police do not perform well, citizens will have recourse to an alternative organization. Thus, it is precisely because no single organization provides all public safety activities or can prevent others from performing similar activities that a monopoly over public safety activities is avoided. Each activity can be adjusted to an appropriate scale and the resulting overlapping of organizations can resolve the monopoly problem. Public goods theory, then, when applied to activ-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ities rather than entire functions, aids our understanding of federal systems in a way that is consistent with federalist theory and market economics.

The substitutes that preclude monopolization in the public sector are not the same as "perfect substitutes" or identical products so popularized in developing welfare conclusions from models of "perfect competition." Substitutes need not be perfect (e.g., a fence and guard dogs may substitute for a police patrol) to stimulate competitive behavior among producers. This concept of competition is associated with Smith and is well expressed in Hayek's "The Meaning of Competition" (1948); it is not the much narrower view of a perfectly competitive market.

Competition

Competition is a key theme in Smith and in the *Federalist*, and a closer look at how the concept of public goods is used in the fiscal federalism literature shows that competition can be included in that analysis as well. Given the importance of competition, it is important to ask if there are situations where competition goes wrong. Two such situations are directly relevant: problems of common property and imperfect information.

The Problem of the Commons

In economic theory, competition "goes wrong" when users compete to use a commons, which is a resource for which property rights are only partially defined (a right to use but no right to exclude others from use). The "tragedy of the commons" occurs when the value to users is sufficiently great that users overuse and destroy the commons, leaving everyone worse off than they would be had they been able to agree on a more complete assignment of property rights for rationing purposes. The problem of the commons, which arises because of an inadequate specification of basic property rights, clearly creates a situation where competition leads to undesirable results.

Studies of the commons began with an examination of "unowned" natural resources, such as fisheries and groundwater (Gordon 1954), but the analyses have been expanded to include the destruction of public goods after congestion sets in, as occurs in public parks. The general principle is simple: whenever the benefits of something exceed its realized costs, people will choose to have it, even if the sum of their costs plus costs imposed on others exceed total benefits. In government, the most striking example of this problem is that many politicians, bureaucrats, and citizens appear to view the public

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

treasury as a commons that each wants to use for his or her own benefit. Special interest groups find that their special benefits exceed their tax increase (which is spread over all taxpayers) for their special project, even though all citizens may end up paying to finance all special interests that exceed their own benefits. This problem is likely to be even more severe if expenditures are financed with deficits.

The usual suggestions for resolving the "commons problem" are either assigning complete property rights or introducing a monopoly regulatory agency with the coercive power to limit access. Both suggestions constitute fundamental changes in the legal structure and are analogous to effective changes in the Constitution. This problem is clearly one that can emerge from competition among politicians and bureaucrats to satisfy citizen preferences in a federal system.[12]

The Problem of Imperfect Information

A second area where competition may appear to go wrong is where consumers or producers possess only biased or imperfect information. In order to make good decisions on the use of scarce resources it is necessary to have a system that produces and makes available information on demands, opportunity costs, and production alternatives. A major argument in Smith and refined in Hayek (1945) is that markets produce and transmit this information in the form of prices more effectively than could a mercantilistic state or a central planning agency. In fact, it is because markets operate on the basis of decisions made in response to prices that many economists call market systems "price systems," and most economists would be at a loss to explain how a market system could work without prices. Applying the logic of markets to federalism then leads to very important questions: Are prices really necessary for the operation of complex systems? And what are the prices in a federal system?

The first question can be answered in the negative. An example would be the ecological survival of the fittest model where organisms or species are adapted to fit the environment and may not engage in any purposeful behavior. If there were tighter control between citizens and preferred policies so that governments that did not meet expectations were eliminated, the system would adapt to citizen preferences even without prices or conscious attempts by management to meet citizen preferences. Both Alchian (1950) and Tiebout

[12]The literature often refers to the negative consequences of competition within government as resulting from "rent seeking" (Buchanan et al. 1980).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

(1957) have explained such a model in economics, but most of us would expect purposeful human behavior with the right incentives to result in an improvement over a pure no-information random adaptive system. We should be aware, however, that a large federal system can operate—and may be operating—without the kind of prices that economists consider necessary to get efficient resource allocation.

The problems of introducing prices that reflect values and opportunity costs into the public sector are serious ones. In order to intentionally undertake production to satisfy customers, managers have to know demand prices, resource prices, and the production function (the relationship between resources and the value they add to the output). Given the nature of many governmental activities, the prices necessary to make these decisions are largely unknown. For example, there is no quantitative measure for "public safety," let alone a demand price; nor is there precise information on the contribution of different resources—such as police cars, policemen, computers, and crime laboratories—toward the objective. In short, managers do not know either the demand price or the production function for many government activities. Of course, there are other activities, such as water supply or garbage collection, where prices can be identified and the production function specified without difficulty, although the way in which the public sector is organized makes it possible that such information will not be as readily available to managers or elected officials as it would be for comparable activity in the private market. Given the range of activities in which governments are engaged, such diversity in government activities should be anticipated.

Federal systems do not produce the same price information as do "ideal" market systems, nor are they likely to produce as much price information as do real market systems. The information problems, however, may be more a matter of degree than of fundamental difference. For example, large corporations undertake many activities internally and must make management decisions without knowing the precise contribution to output of some activities. It is also difficult to measure the outputs of many private firms, such as a law firm. In these cases, the conditions of "perfect competition" are not met; but as long as markets are competitive, those businesses that do relatively better are most likely to survive and provide net benefits to consumers. Thus, while one must recognize the difficulty of developing ideal prices in federal systems (and try to improve information where possible, such as with contracting-out), the lack of ideal prices is not a barrier to using market models to understand federalism. Explicit recognition of the lack of ideal prices, however, reemphasizes the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

potential lack of relevance of economic models that include as a basic assumption the availability of perfect information.

Implications of a Market Perspective

The major arguments of the paper can be summarized as follows:

1. The basic way of thinking in market economics, such as is presented in Adam Smith's *Wealth of Nations*, is highly congruent with the way of thinking about government presented in the *Federalist*. Both view people as acting in their own self-interest; both are aware of the difficulty of producing and transmitting information; both place considerable importance on competition to get good results for consumer/citizens; and both oppose the creation of monopolies.
2. Empirical evidence supports the position that greater competition can improve production efficiency (contracting-out) and that governments will engage in collusive behavior to the disadvantage of citizens (LAFCOs).
3. Recognition of the difference between functions and activities when applying the concept of public good can reconcile federalist and market approaches with the fiscal federalism literature. This approach also indicates the importance of a broad definition of substitutes, not just the identical substitute of perfectly competitive models.
4. Competition may lead to undesirable results when it is for a commons, and the public treasury may be analogous to a commons when viewed by special interests.
5. Federal systems do not generally produce as much price information as do private markets, but they still function more like markets than like single firms or hierarchical bureaucracies.

The Constitutional Convention of 1787 created a framework that has facilitated economic development and has left the United States one of the best governed nations in the world. While that was no small achievement and should not be underrated, social scientists who study the public and private sectors should be proposing ideas that will improve things. If they are right, there may even be some changes.

Before one can make recommendations, however, it is necessary to understand how something works. In order to understand the U.S. constitutional system, it is necessary to understand federalism. The *Federalist* provides an excellent basis for understanding how federalism works, but the logic of economics also makes a major contribution because of the congruence between the theoretical framework

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

presented in the *Federalist* and the theory of markets. This does not mean that we can simply adopt Smith's conclusions, even if supplemented by the analyses of public choice theorists, and apply them to the public sector; but it does mean that we can use the logic of market economics to understand federalism more fruitfully than has been done in the past.

References

Ahlbrandt, Roger S. Jr. *Municipal Fire Protection Services: Comparison of Alternative Organizational Forms.* Beverly Hills: Sage, 1973.

Alchian, Armen. "Uncertainty, Evolution and Economic Theory." *Journal of Political Economy* 58 (June 1950): 211–21.

Bish, Robert L. "The Assumption of Knowledge in Policy Analysis." *Policy Studies Journal* 3 (Spring 1975): 256–62.

Bish, Robert L. *The Public Economy of Metropolitan Areas.* Chicago: Markham Rand McNally, 1971.

Bish, Robert L. "Economic Theory, Fiscal Federalism, and Political Federalism." Paper presented at the Annual Meeting of the American Political Science Association, Washington, D.C., 1–4 September 1977.

Bish, Robert L. "Competition and Collusion: Some Implications From a Public Choice Perspective." In *Intergovernmental Policymaking.* Edited by K. Hans and F. W. Sharps. Beverly Hills: Sage, 1978.

Bish, Robert L. "Improving Productivity in the Government Sector: The Role of Contracting Out." In *Responses to Economic Change,* pp. 203–37. Edited by David Laidler. Toronto: University of Toronto Press, 1986.

Bish, Robert L., and Ostrom, Vincent. *Understanding Urban Government: Metropolitan Reform Reconsidered.* Washington, D.C.: American Enterprise Institute, 1973.

Boschken, Herman L. "Organization Theory and Federalism: Interorganizational Networks and the Political Economy of 'The Federalist'." *Organization Studies* 3, no. 4 (1982): 355–73.

Buchanan, James M. "Positive Economics, Welfare Economics, and Political Economy." *Journal of Law and Economics* 2 (1959): 124-38.

Buchanan, James M., and Tullock, Gordon. *The Calculus of Consent.* Ann Arbor: University of Michigan Press, 1962.

Buchanan, James M.; Tollison, Robert D.; and Tullock, Gordon, eds. *Toward a Theory of the Rent-Seeking Society.* College Station: Texas A & M University Press, 1980.

Downs, Anthony. *An Economic Theory of Democracy.* New York: Harper and Row, 1957.

Gordon, H. Scott. "The Economic Theory of a Common-Property Resource: The Fishery." *Journal of Political Economy* 62 (April 1954): 124–42.

Hamilton, Alexander; Jay, John; and Madison, James. *The Federalist.* New York: The Modern Library, n.d.

Hayek, Friedrich A. "The Use of Knowledge in Society." *American Economic Review* 35 (September 1945): 519–30.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Hayek, Friedrich A. "The Meaning of Competition." In *Individualism and Economic Order*, pp. 92–106. Chicago: University of Chicago Press, 1948.

Head, John G. "Public Goods and Multilevel Government." In *Public Goods and Public Welfare*, pp. 263–84. Durham: Duke University Press, 1974.

Hobbes, Thomas. *Leviathan*. 1651. London: Collier-Macmillan, 1962.

Martin, Dolores Tremewan. "The Institutional Framework of Community Formation: The Law and Economics of Municipal Incorporation in California." Ph.D. diss., Virginia Polytechnic Institute and State University, Blacksburg, 1976.

McDavid, James C. "The Canadian Experience with Privatizing Solid Waste Collection Services." *Public Administration Review* 45 (September/October 1985): 602–8.

McKenzie, Richard B., and Staaf, Robert J. "Revenue Sharing and Monopoly Government." *Public Choice* 33, no. 3 (1978): 93–97.

Musgrave, Richard A. "Theories of Fiscal Federalism." *Public Finance* 24, no. 2 (1969): 521–32.

Nathan, Richard P. "Federalism and the Shifting Nature of Fiscal Relations." *Annals* 419 (May 1975): 120–29.

Niskanen, William A. *Bureaucracy and Representative Government*. Chicago: Aldine-Atherton, 1971.

Oates, Wallace E. *Fiscal Federalism*. New York: Harcourt Brace Jovanovich, 1972.

Olson, Mancur. *The Logic of Collective Action*. Cambridge, Mass.: Harvard University Press, 1965.

Olson, Mancur. *The Rise and Decline of Nations*. New Haven: Yale University Press, 1982.

Ostrom, Vincent. *The Political Theory of a Compound Republic: Designing the American Experiment*. Lincoln: University of Nebraska Press, 1987.

Rothenberg, Jerome. "Local Decentralization and the Theory of Optimal Government." In *The Analysis of Public Output*, pp. 31–64. Edited by Julius Margolis. New York: Bureau of Economic Research, 1970.

Scott, Anthony. "The Defense of Federalism, or, The Attack on Unitary Government." *American Economist* 17 (Fall 1973): 162–69.

Smith, Adam. *The Wealth of Nations*. 1776. New York: Modern Library, 1937.

Tiebout, Charles M. "A Pure Theory of Local Expenditures." *Journal of Political Economy* 64 (October 1956): 416–24.

Tiebout, Charles M. "An Economic Theory of Fiscal Decentralization." In *Public Finances: Needs, Sources, and Utilization*, pp. 79–96. National Bureau of Economic Research. Princeton: Princeton University Press, 1961.

Tiebout, Charles M. "Location Theory, Empirical Evidence and Economic Evolution." *Papers and Proceedings of the Regional Science Association* 3 (1957): 75–82.

Tullock, Gordon. *The Politics of Bureaucracy*. Washington, D.C.: Public Affairs Press, 1965.

Wagner, Richard E. *The Fiscal Organization of American Federalism*. Chicago: Markham Rand McNally, 1971.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Warren, Robert. "A Municipal Services Market Model of Metropolitan Organization." *Journal of the American Institution of Planners* 30 (August 1964): 193–214.

Warren, Robert. *Government in Metropolitan Regions: A Reappraisal of Fractionated Political Organization.* Davis: Institute of Governmental Affairs, University of California, 1966.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Federalism from a Market Perspective

David W. Rasmussen

Introduction

Arguing that the *Federalist* is an intellectual cousin of Adam Smith's *Wealth of Nations*, Robert Bish desires to show how an understanding of exchange helps us understand how our federal system operates. Federalism is seen as a mechanism to constrain the government's power to pursue its interests at the expense of the governed. In seeking a solution to this "monopoly problem" Bish sees the Federalists sharing with Adam Smith the insight that competition is the most effective antidote to monopoly. Principles of exchange in the Federalist system are exhibited in a division of labor among many governments and the Founding Fathers' awareness that individuals know their own preferences but not those of others. Like Smith, they wrestled with the problem of how citizen preferences can be made known to their representatives.

In this commentary we will discuss the role of competition in our federalist system, emphasizing two aspects of Bish's paper while largely ignoring significant areas of agreement. First, it is argued that Bish may be exaggerating the principles that link the economic market perspective to American federalism. Secondly, Bish does not discuss adequately the public sector's role in the redistribution of resources, a dominant feature of contemporary federalism.

Economists' affection for market analogies to the public sector are based on what Albert Hirschman (1970) called the exit option. Exit is the primary way consumers register their displeasure with producers in markets. If a firm's product does not please a customer in a competitive market, he simply buys from a different firm. This principle is basic to Tiebout's (1956) model of fiscal decentralization which emphasizes citizens vote with their feet in search of a preferred tax/service combination.

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.
The author is Professor of Economics and Policy Sciences at Florida State University.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Competition among governments may be a potent antidote to the monopoly problem in the United States. Exit has been an integral part of the American character. Most Americans have roots in a foreign country, the Western frontier offered opportunities for exit from the East, and the affluent deserted our central cities to form new suburban governments. The Federalists, however, may have placed more value than Bish on Hirschman's alternative to exit, i.e., voice—involvement in the political process. That voice would be dear to the heart of the Federalists is suggested by Bish when he notes that they argued policy should be "debated and scrutinized in several forums to be certain that the viewpoints . . . are considered before adoption." Bish dismisses the reliability of this political process as a means to combat the monopoly problem in one sentence because of "economic analysis."

Bish's rejection of political competition in favor of the voluntary exchange model as a solution to the monopoly problem may not reflect Federalist thought. Aside from their interest in political involvement, a resurrected Federalist might object to Bish's contention that they constructed a political system analogous to the competitive economic marketplace. Not trusting central government power, the Constitution divides power among three branches of government. In setting up the system of checks and balances for which our Constitution is famous, the Founding Fathers in fact set up a system of countervailing power—a system very different from the competitive processes envisioned by Bish. Rather than interpreting the *Federalist* as a companion volume to the *Wealth of Nations*, the Founders could be thought of as having anticipated Galbraith's (1956) interpretation of American capitalism.

Competition and the Monopoly Problem

Bish states that "contracting-out with competitive bids eliminates the monopoly position of the government bureaucracy and introduces more information and competition into the system." The availability of private production provides information with which the government, political entrepreneurs, or citizens can evaluate public production of the service. As long as the government has a statutory responsibility for the service (e.g., incarceration of criminals) it inherently has a "monopoly" on the provision of the service although it can choose not to produce the service. This important distinction between provision and production of public goods is emphasized by Bish in another context. Hence the question to be answered is why

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

does the government decide to contract-out to a low-cost private producer?

One answer is that elected officials want to "do good" rather than "do well," that is, they are benevolent monopolists. There is no reason to deny that some elected officials may genuinely act on principles of good government (which would imply low-cost contracting-out if public production was inherently more costly). Nevertheless, this seems a weak foundation on which to build our hopes for good government.[1]

An alternative is that electoral competition may force public officials to adopt cost-effective private alternatives to public production. Although Bish probably would reject this hypothesis, much can be said for this argument. First, let us assume that citizen-voters are satisficers in their consumption of public services. This generally plausible interpretation of human behavior (see Simon 1952) is particularly appealing in the public arena where it is often difficult to measure output or quality of service. In contrast to finely tuned maximizers seeking marginal advantages, these satisficers respond only when actual outcomes deviate significantly from the optimum.

We now assume the public sector is providing a service for which private production can be substituted at apparently lower cost. If the advantages of contracting-out are significant and clear, a political entrepreneur may seize this issue to improve his well-being, that is, by wresting office from an incumbent or solidifying his political position. Whether a political entrepreneur enters the political marketplace over this issue depends on the elasticity of response of electors to the perceived savings from contracting-out the service to private vendors. The elasticity of response to cost differences (and quality variations) will depend on the size of the item in the government budget, the ease with which cost differences can be demonstrated while assuring quality is maintained, and the risk associated with a breakdown in the service.[2]

[1]A bureaucrat might contract-out to a low-cost private producer in order to get additional discretionary resources. Public benefits from this lower cost production, either additional services or lower taxes, may not be forthcoming in this situation.

[2]That voters will not respond to cost savings in trivial budget items is straightforward. In many cases, however, cost savings provided by private vendors may be suspected of harboring declines in quality. For garbage collection the cost comparisons are straightforward and the quality of service clear, e.g., number of pick-ups per week. Garbage is readily contracted-out. The Thatcher government's 1986 proposal to privatize water services in the United Kingdom represents a complicated issue with uncertainty about quality when costs differentials are known. In this case, debate focused on the quality question and the uncertainty of monitoring potentially hazardous practices of private vendors. Oliver Williamson (1976) emphasizes that the complexity of contracting-out some services can undermine the feasibility of privatization.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The political marketplace is highly competitive in that there are always new entrants hoping to displace the old. Indeed, it is entirely possible that political entrepreneurs share an important characteristic with their economic counterparts, that is, they are most innovative before they hit the "big time." Bish notes that substitutes need not be perfect to preclude monopolization; this observation seems to be as apropos in support of the efficacy of the political marketplace as in Bish's arguments for alternative institutions to prevent monopoly power by the government.[3] While Bish has made an interesting contribution in noting some of the similarities between Federalist thought and that of market economics, he has probably underestimated the role of the same competitive forces at work in the collective decisionmaking process.

Political competition, like competitive markets in economics, can go awry. This is widely recognized. Bish applies the "commons problem" to the federal budget, claiming that "many politicians, bureaucrats, and citizens . . . view the public treasury as a commons that each wants to use for his or her own benefit." Thus we are not assured political competition will yield a desired result—the monopolist government may go unchecked.

Modern Fiscal Federalism

Political competition as outlined above probably works best for relatively small local governments (Bish 1971). Investigation of the division of labor among U.S. governments suggests that it is the state and local governments that provide services for people while the federal government is more oriented toward redistributive activities. Of course, the federal government is a monopolistic supplier of national defense. In 1981 about 88.9 percent of state and local expenditures were for current operations, capital outlay, and interest. Public welfare accounted for about 11 percent of outlays; half of which were financed by the federal government. In contrast, 47 percent of federal expenditures were for redistributive activities via payments to individuals. This figure increases to 62 percent if the transfers are taken as a percentage of nondefense outlays.

These data suggest that political competition and competition among governments are such that the state and local public sector avoids a serious monopoly problem in that they provide services to citizens

[3]William Baumol's (1982) concept of "contestable markets" rests on the premise that a monopolist could be held in check by potential competition, i.e., a monopolist is aware that potential rivals make his position vulnerable. Politicians are clearly engaged in contestable markets in that they are aware of potential but as yet unknown competition.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

who have competitive alternatives. Benson and Johnson (1986) support this view when they report that tax competition among states is a significant force affecting the location of manufacturing investment.

The federal government has evolved to the point that income redistributive activities have grown to rival the goods and service producing functions. Bish's discussion of the concepts of competition implicit in the *Federalist* does not provide much insight into the growth of this phenomenon—redistribution is only mentioned in the context of the commons problem. Implicitly, his treatment of redistributive activities suggests that market failure is characteristic of the operations of the monopolistic federal government. Viewed in this light it is possible to argue that our bold constitutional experiment really failed, that the commons problem at the federal level associated with political competition ultimately resulted in a trammeling of the citizens rights via confiscatory redistributive schemes.

Considering the composition of these transfer payments, this judgment may be too harsh. Of total transfers to domestic persons, the Social Security programs aiding the elderly, disabled, and surviving dependents account for 65 percent; including retirement programs raises this figure to over 77 percent. Widespread political support for Social Security does not suggest this program represents a trammeling of citizens' interests; in fact support may rest on the proposition that virtually the entire population will ultimately receive some benefits. Although the most affluent members of society may prefer private insurance, there is no evidence that this large transfer program is government run amuck vis-à-vis citizen preferences.

Since Musgrave (1959) enunciated the division of labor among governments, conventional public finance has emphasized that the federal government should take the lead in redistributive activities while the local governments should primarily provide goods and services. As a nation proceeds from an agricultural society to a highly urban industrial economy, the bonds of community and family become weakened from rising mobility and the decline of the family as an economic unit for the production of goods and services. In this context, we may expect an increase in redistributive activities, reflecting a commendable institutional flexibility in response to the economic development process. However one judges this rapid rise of federal redistributive activity in the past two decades, the role of transfers in our federalist system must be carefully considered in any discussion that seeks to clarify our understanding of modern fiscal federalism.

References

Bish, Robert L. *The Public Economy of Metropolitan Areas.* Chicago: Markham Rand McNally, 1971.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Baumol, William J. "Contestable Markets: An Uprising in the Theory of Industrial Structure." *American Economic Review* 72 (March 1982):1–15.

Benson, Bruce L., and Ronald N. Johnson. "The Lagged Impact of State and Local Taxes on Economic Activity and Political Behavior." *Economic Inquiry* 24 (July 1986):389–401.

Galbraith, John K. *American Capitalism: The Concept of Countervailing Power*. New York: Houghton Mifflin, 1956.

Hirschman, Albert O. *Exit, Voice, and Loyalty*. Cambridge: Harvard University Press, 1970.

Musgrave, Richard A. *The Theory of Public Finance*. New York: McGraw-Hill, 1959.

Simon, H. A. "A Behavioral Model of Rational Choice." *Quarterly Journal of Economics* 69 (1952):98–118.

Tiebout, Charles M. "A Pure Theory of Public Expenditures." *Journal of Political Economy* 64 (October 1956):416–24.

Williamson, Oliver E. "Franchise Bidding for Natural Monopolies—in General and with Respect to CATV." *Bell Journal of Economics* 7 (Spring 1976):73–104.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Reflections on Freedom, Fairness, and the Constitution

Richard L. Stroup

Introduction

Freedom (with accountability) is the key to both prosperity and to any reasonable and realistic conception of fairness. Only with entrepreneurial freedom will the innovation required to increase prosperity occur. And only through freedom and prosperity can fairness—in the sense of benefits accruing to those with low incomes, as well as fair treatment under the law—be maintained. Both freedom and prosperity are incompatible with extensive regulatory or tax/transfer powers in the hands of government. This paper argues that freedom, fairness, and prosperity are unalterably linked and require strong constitutional constraints on government.

A powerful case can be made for small, secure, but constrained and competing governments of the sort a federal system suggests. As James Buchanan's work indicates, in today's world Hobbesian anarchy is not likely to yield freedom, economic growth and prosperity, or fairness. In this world, I believe we do need government.

Restraints on government, however, are the key to freedom and fairness. Few would dispute the need for restraints to maintain freedom, but the restraints on government are necessary for fairness as well. Why? Individuals are not equally endowed with effectiveness in market earnings, nor in the market for political influence. There will be elites in any system, and those who are not members of the elite are far better off when the influence of elites is diffused, as in a free society with constrained government—with freedom of entry and exit, operating under the rule of willing consent. Thus a government with the power to prevent arbitrary abuse of some people by others, but with sharply limited power to coerce others directly and

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.

The author is Professor of Economics at Montana State University and Senior Associate at the Political Economy Research Center in Bozeman, Montana. The paper was written when he was acting as Senior Research Associate at Florida State University.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

in detail, is likely to provide maximum freedom, and hence maximum prosperity and fairness as well.

Arguably, limits on government can persist over time only when protected at the constitutional level. Several papers in this volume, and especially Buchanan's, show the need for procedural and constitutional restrictions to restrain the power of central government. Even the competition among states for citizens and capital (and thus a tax base) inherent in a federal system, important though it is, cannot by itself constrain the powers of the central government. The latter, if unrestrained in this regard, can help state governments to collude in efforts to redistribute wealth and favor to the politically powerful, using federal regulations and federal taxes.

In this view too pessimistic? Can we not depend on politicians of high principle to eschew political advantage in seeking out the public good? No, because without constitutional constraints, competition among politicians and candidates for political support in a representative democracy almost guarantees the growth of programs redistributing wealth and advantage from the politically unorganized to the politically organized and influential. This result does not depend on the actions of venal or unprincipled politicians. Instead, we need to recognize that those politicians who are unwilling to work effectively to help organized special interests, via logrolling and political entrepreneurship of all sorts, tend to be outcompeted by those who are more willing and more able to do so.

Fairness and the Failure of Redistributive Policies

Although economists often profess not to know what fairness means, we can all agree that a system *perceived* as unfair lacks the legitimacy critically needed by any regime in a representative democracy. The perception of fairness in the system is a prerequisite to the survival of our free society, and the way in which income is distributed can greatly affect the perception of fairness.

Suppose we accept the Rawlsian criterion for fairness: a change is fair if it helps the worst-off among us. How *are* those at the bottom of the income ladder helped most? Through economic growth! That is the only program that has consistently helped people to escape the blight, all-too-common in world history, of exceedingly low (by current American standards) standards of living.

How Unconstrained Tax and Transfer Programs Lead to the Reduction of Freedom

In contrast to economic growth, the larger burdens on producers and the benefits to recipients of tax-transfer programs will lead unin-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

tentionally, but inexorably, to the reduction of individual freedoms and the perpetuation of unfairness. Consider the income tax. As rates rise, evasion becomes more attractive. Taxpayers feel morally justified in trying to escape the growing burden, and it increasingly pays them to find sophisticated tax dodges. As a consequence, either cheaters prosper relative to honest taxpayers, or the Internal Revenue Service must be given broader powers to surveil, to police business practices and individual behavior, and to force compliance.

On the spending side, even well-funded programs must be targeted so that most can be kept from sharing the spoils, or their participation at least limited, in order to concentrate benefits primarily on those who have "earned" them—the intended beneficiaries who have successfully expended political resources to obtain the program benefits. This effort to exclude also requires increased governmental monitoring and enforcement powers. Acreage limitations on farm programs might have to be established and policed, for example, to prevent new entrants from capturing the fruits of large farm subsidies. Otherwise the program will be horrendously expensive.

Financially attractive government programs draw new participants unless and until the cost of entry for potential newcomers offsets the program advantages. People always try to utilize their land, labor, and capital in activities that offer greater rates of private return—returns they can keep and spend themselves. They will refocus their efforts and reinvest their capital as they move their resources toward higher paying ventures. Such movement of resources will stop only when the private rate of return is the same in each endeavor.

The Political Unattractiveness of Programs to Aid the Politically Ineffective

Political realities militate against expanding government programs that promote Rawlsian fairness, especially programs intended primarily to alleviate poverty. When tax-transfer programs grow, the reactions of both taxpayers and recipients tend to offset the stated intentions of the program. In addition, programs for redistribution toward the poor have few strong and consistently effective political allies. James Gwartney and I (1986) explained how these factors combine to make the dream of political redistribution unattainable, and provided evidence from the U.S. experience in support of our theory. The blunt fact is that it is nearly impossible to politically redistribute income systematically toward the poor (or any other category of people), aside from conferring windfall gains on them.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Why, then, do programs for redistribution persist beyond the stage at which the successful special interest lobbyists have received their windfall gains? As Gordon Tullock (1975, 1986) has shown, the transitional gains trap explains why there is a strong built-in demand to continue transfer programs that have already provided windfall gains. To eliminate the program is to harm those who have already adjusted to the program or who are currently enjoying its benefits. Those individuals who would be hurt are a concentrated, often vocal lobby against program cutbacks.

Both economic logic, including public choice theory in particular, and the empirical evidence from around the world and over time, indicate that governments' intentions, or stated intentions, to redistribute income from rich to poor simply do not come to fruition in practice. Given the need for political effectiveness to achieve that stated goal, we should not expect success. Given the responses over time of people to any such tax-transfer program, we should expect the lack of political incentive to be reinforced by the lack of effective political and economic tools to achieve the result in any case. Greater governmental control over incomes does not, in fact, systematically increase measured income equality: strong incentives are typically missing and even the best of intentions would not be enough. The strength of the forces tending to equate the rates of return in each economic activity is very great indeed.

When we politicize income distribution, or any other matter of concern, those with political power will reap the windfall gains—and in the real world, the rich are nearly always and almost everywhere more politically powerful than the poor, in addition to being economically more effective. Recognizing these realities, we should not be surprised at the fact that today only one of every six dollars redistributed by the federal government is part of an income-tested program. In most programs, as judged by their stated distribution criteria (as opposed to the rhetoric of supporting lobbyists) there is not even the pretense of systematically helping those of smallest means.

Pushing Back Poverty: The Role of Economic Growth

Poor people do best with growth and prosperity, as do others, when opportunities are created for everyone. Both Adam Smith and Karl Marx agreed that prosperity is achieved by voluntary exchange in free markets. Is "fairness" an important policy criterion? Is helping those who are least advantaged important to fairness? The *best* way

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

to increase the smallest slice of a national pie is to make the pie bigger (see Gwartney and Stroup 1986). Growth truly is the way to make all of society better off. For this reason it is important that most economic decisions not be in the hands of government officials empowered with substantial discretion. The ability of such individuals (or committees or agencies) to show favoritism, to help "worthy" groups creates a nearly irresistible pressure on participants to make politically advantageous decisions, not efficient ones or ones that favor powerless individuals and groups. In order to foster growth, the role of government is best limited to preserving predictability of the law and to seeing that individuals are not victimized by powerful minorities, especially the elite. Income distribution is an important determinant of how much wealth is available to the society as a whole. How much goes to those who produce additional wealth, and how much to those concentrating more on simply manipulating the strong arm of government, for example, will strongly influence how much income is produced. The activities best rewarded are those most likely as a result to increase the most. Thus income growth and fairness are closely connected.

Economic growth requires free entry and free experimentation to encourage innovation. Yet innovative ideas are usually judged, early on, to be "crazy" for the perfectly good reason that most are. Yet the few that turn out to be good ones are critical—they do in fact lead to growth. But when decisions are governmental, only those ideas accepted as valid by the majority are properly provided with society's resources. In contrast, when private individuals and groups of investors wish to commit their own funds and efforts, only they need to be believers. The private sector, for this reason, is more likely to make erroneous investments. But since their own wealth is at stake, private investors also have a strong incentive to promptly acknowledge, and to terminate the many ventures which turn out, in hindsight, to have been mistaken. That means that collective or majority control is unnecessary and indeed undesirable.

The presence of individual and small group freedom and accountability encourages entrepreneurial search and experimentation. So long as accountability is present, so that innovators cannot commit the resources of others without the owners' consent, government regulation and financing are the *antithesis* of the needed conditions for growth. But because each special interest group believes it deserves special treatment and demands it from the politicians in exchange for political support, we must have constraints on the power of government to determine which innovations will be tried, and which will be halted. In particular we must have constitutional constraints

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

on what government can do in the capital market as well as the output market. Otherwise "pie slicing" via redistributionist political activity will come to dominate "pie enlarging" or adding to productivity, in the activities of individuals. If we allow government the power to distribute favors, the competitive political marketplace will provide persistent advantage to politicians who find ways to reward these special interests, and the bureaucracies which try to serve them.

The Morality of Pie-Enlarging and Pie-Slicing Activities

Most would probably agree that the primary purpose of government, and the reason we endow it with a monopoly on legitimized force, is to enhance the lives of the citizenry as a group—to make society's pie larger, so to speak. The promotion of redistribution exercises (reallocating everything from education priorities to money) at the expense of economic growth not only reduces the wealth and income to be enjoyed by the society, but also strains the fabric of society by pitting faction against faction, as the Founding Fathers put it. Again both efficiency and equity demand less, rather than more, government control of the economy. Governmental powers themselves must be tightly controlled.

Consider for example what happened when deregulation (brought on more by Ted Kennedy than by Ronald Reagan) reduced the power of government to control airline routes and prices: it *hurt* airline pilots, some of whom were earning $120,000 per year, bringing the starting salary in their occupation down to a mere $42,500 per year. But it *helped* retirees, and blue collar and pink collar workers, who now can afford to visit relatives, see Florida, and travel to the Grand Canyon, on bargain air fares. More travel is done at lower prices. More wealth is created because more mutually beneficial exchange takes place: exchange at terms which had been forbidden under regulation. The previous regime of strong regulation had been helping well-organized (and highly paid) individuals at the expense of unorganized consumers who wanted the bargain fares, and workers who wanted airline jobs but could not get them when prices and wages were artificially high. Again, it is important to recognize that the actual outcome of regulating airline fares and routes had been to force the airline industry to serve the politically effective elites at the expense of the less politically effective common citizen. The people of the nation had given up freedom of contract between buyers and sellers (low cost carriers were not allowed to offer lower prices), presumably in exchange for a better deal for those least able

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

to help themselves economically. Yet those least able to help themselves in the economic arena were typically least well-off in the political marketplace also.

Preserving Freedom and Prosperity

A free society and an effective constitution are not a natural condition for society, if history is any guide. Their existence requires a strong and supportive constituency that continually demands freedom and constitutional government. Our Constitution, as with any component of government, must have a strong constituency to be effective over time. Yet "good government" is quite clearly a public good: each citizen may wish to live in such a system, but each has the incentive to be a free rider in maintaining it. Why pay for your ride, if those who refuse to pay can ride for nothing? This unwillingness to pay the costs of obtaining high-quality information causes most citizens to cast their ballots, if indeed they cast any ballot at all, in a relatively ignorant state. This factor, of course, makes it all the easier for well-organized special interests to have disproportionate influence in a representative democracy.

Maintaining the Constitutional Order

For those of us who are teachers, it is important to inform the coming generation of leaders and voters about how unusual our freedoms are in the world today and in history. Robert Higgs (1987) points out the erosion of Constitutional protection, and makes a convincing argument that we may not have a lot more time to avoid an increasingly authoritarian, probably fascist operation of government. How can that drift be avoided? How can we best try to see that Hayek's "road to serfdom" (1944) does not become a toboggan slide? The moral climate is critical.

Although each voter as an individual has little impact, what voters as a group demand, they probably will get. Only if the populace demands that the economy operate on the basis of individual responsibility, and is willing to adjust the generally superior, but sometimes difficult individual outcomes through private charity and other means, will we have the freedom and the economic growth needed to help the worst-off among us. An economically strong nation has of course another built-in advantage. It can more easily (with a smaller standing army) fend off potential foreign threats. Economic strength is in fact a substitute for currently organized military strength. It was, after all, the strength of the American economy that to a large degree helped

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

defeat the Axis powers in World War II despite the weakness of American forces at the beginning of the war.

It is also worthwhile to note that when an economy is strong because mutually beneficial trade is fostered, competition is turned into cooperation. When this happens, all can gain—and normally do. That is why the social fabric of a free and prosperous society is strong relative to that of a dog-eat-dog world where an unconstrained government takes from the politically weak to protect and give to the politically strong. A free and prosperous society can itself be strong internationally, without the fervor, fanaticism, and hatred of other nations that is sometimes used to extract higher performance from people in an authoritarian society. The strength of cooperative behavior in a free and growing economy can substitute for the fanaticism sometimes used to raise military effectiveness. Mutually beneficial trade is, I hope we can all agree, morally superior to fanaticism.

I personally hope that the Bicentennial of the Constitution, and the study it is causing, will help us all realize the importance of pulling together to back a strong Constitution. It is important to remember that good government is in fact what economists call a "public good"; it has no "built-in" effective constituency. Only a public educated to the dangers of unconstrained government can be expected to demand the necessary constraints. Without constitutional constraints freedom will disappear, and with it will go both prosperity and fairness.

References

Hayek, Friedrich A. *The Road to Serfdom.* Chicago: University of Chicago Press, 1944.

Higgs, Robert. *Crisis and Leviathan: Critical Episodes in the Growth of American Government.* New York: Oxford University Press, 1987.

Gwartney, James, and Stroup, Richard. "Transfers, Equality, and the Limits of Public Policy." *Cato Journal* 6 (Spring/Summer 1986): 111–37.

Tullock, Gordon. "The Transitional Gains Trap." *Bell Journal of Economics* 6 (Autumn 1975): 671–78.

Tullock, Gordon. "Transitional Gains and Transfers." *Cato Journal* 6 (Spring/Summer 1986): 143–54.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Public Trust Doctrine

Richard A. Epstein

Private and Public Property

From the outset political and legal theory have long been divided on the question of whether various forms of natural resources are in the original position held in common ownership or, alternatively, are subject to private ownership by individual acts of appropriation. Locke, for example, tries to work both sides of the street. He first appeals to Biblical authority to demonstrate that God gave mankind the earth to be held in common: "God, as King David says, Psalm cxv.16, 'has given the earth to the children of men,' given it to mankind in common." (Locke 1690, ch. 5, ¶25). Thereafter he argues that individuals "fix" their property in that portion of the common good with which they mix their labor, even when they act without the consent of others.

Locke's argument rested in part on a theistic foundation. Once that is removed, however, accounting for property rights is far more difficult, for there is no obvious starting point for the analysis, as mankind in general cannot be regarded as joint donees who take by transfer, rather than by acquisition. Locke's argument does not tell us how to think about property when there are no rights, and no grantor, in the state of nature. No longer is the inquiry, how does one get private rights out of public ones, or indeed how to get public rights out of private ones. No longer is there any necessary presumption that all property rights should be either private or public. A mix of rights, some public and some private, is surely conceivable, even if their relative proportions are unclear. Historically, both the common law and Roman traditions were able to accommodate both forms of property, with the navigable waters being perhaps the most nota-

---

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.

The author is James Parker Hall Professor of Law at the University of Chicago. He wishes to thank Carol Rose for her extremely valuable comments on an earlier draft of the paper.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ble forms of public property—often "inherently" so (see Rose 1986; Sax 1970). The task for a unified theory of property is to develop an account of the original position which accomplishes two things. First, it allows for some property rights to be private and others to be public. Second, it permits correction of any initial allocative mistakes by providing a way for assets to move from one regime of property rights to another. In dealing with these two themes, my emphasis is on property that is owned by the public at large. The "public trust" title given to the paper refers to the legal rules that limit the power of the people, or (in time) the legislature, to dispose of public property.[1]

In addressing the original position, no government is already in place with the power to assign rights in property to single individuals or the public at large. Locke may not have established that mankind in common is the donee of all property, but surely he demolished the divine rights of kings. The inability to locate the original grantor of property in God or in the state has had profound consequences on the shape of political theory, for it has forced both legal and political thinkers to take a more explicit consequentialist view of legal rules and social arrangements. The task of justification has been to show what general set of legal institutions will advance the welfare of the public at large, when measured against its next best alternative. The task is surely daunting, as there is no obvious means to take information about individual utilities and combine them into any unique social welfare function. But by the same token that task is in some sense quite unavoidable: for if one does not look to *any* of the consequences of legal rules, however nebulous and uncertain, then what could furnish a justification for any practice?

In addressing the original position, I believe that the most fruitful line of inquiry stresses the relationship between the rules of transfer and the rules of original ownership (see Holderness 1985). In some logical sense rules of initial acquisition are necessarily prior to the rules of transfer. After all, how can anyone transfer property that he

[1]In more recent times efforts have been made to expand the scope of the public trust doctrine so that a public trust is impressed upon ordinary private property simply because individuals have notice of the types of regulations that might be imposed. "Expectations must be deemed to change as time, circumstances and public attitudes change, and expectations which might have been reasonable at one time can cease to be reasonable." See Sax (1981, p. 10). Stated in this form, the public trust doctrine strays from its original function, that of limiting government power over public assets, and addresses a new function, that of expanding government power over private property. The newer approach to the public trust doctrine is simply another unfortunate effort to create instability in private rights, in harmony with the modern efforts to eviscerate the eminent domain clause. I have said enough about eminent domain already (see Epstein 1985a) and do not address this constellation of issues further here.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

does not own? Yet in another sense one can determine the rules of original acquisition only with an appreciation of the importance of the rules of transfer. The needed explanation rests in a single phrase: "mutual benefit." There are all sorts of reasons why someone who now owns one thing no longer wishes to keep it: I want to sell my house in Chicago because I have a new job out of town. A rule of voluntary exchange allows the owner to get rid of something he has in order to acquire something to which he has greater value. In the ordinary case, these rules of exchange leave both parties to the transaction better off than they were before; otherwise they would not enter into them. The mutual benefit between the parties creates a presumption that the transfer in question is a social good, for someone is better off and thus far no one is worse off. But this presumption is not absolute. In turn it could be rebutted by a showing that the transfer has created negative effects on some third parties.

Here there is need to be careful, for every transfer has *some* negative external effects on the welfare of at least one third person. Nonetheless the overall effects of voluntary exchange will usually be positive. The increase in wealth of the immediate parties will generally increase the opportunities for exchange left open to all third parties. The disappointed competitor in the one case may well turn out to be the successful bidder in the next, so a system of property rights which facilitates free exchange is one that will in the long run work to the advantage of all its participants by increasing the amounts of available goods and services. In marriage markets, for example, no one would (I hope) think that A's decision to marry B and not C, could justify a system of regulation that would oust the principle of joint consent. The usual libertarian line has been that between competition and violence, and it is a very accurate proxy for which rules have, in the aggregate, third party effects that are overall negative or positive. In the absence of force, or the threat of force against third parties (Epstein 1985b), it is very difficult to rebut the original presumption that ordinary voluntary exchanges (unlike contracts to kill or steal) should go forward.

Voluntary exchanges are then a critical part of any sensible legal system. The question of whether these exchanges in fact can take place is, however, critically a function of the original design of a system of property rights. Here of course it is quite impossible for any human being or human institutions to engage in self-conscious acts of deliberation that will yield some perfect set of original rights or for that matter a perfect set of legal institutions. The line between violence and competition is, for example, a first approximation, one which leaves open the limited possibility that further corrections can

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

be made in the original allocation of rights should the circumstances require it: for example, some laws restricting the enforceability of cartel arrangements. The questions to be asked, therefore, are two: What rules will in general promote voluntary transactions? And what methods does the legal system have to "correct" those original allocations that turn out to be arguably wrong? The first of these questions addresses the mix of public and private property. The second addresses the role of the eminent domain principle and its analogue for public property, the public trust doctrine. The eminent domain rules govern the forced conversion of private to public property. Rightly understood, the public trust rules do the reverse, and govern the forced conversion of public to private property.

The Original Position

The first question is, why should some things be regarded as unowned in the original position and others subject to a common indivisible ownership? I believe that a single theory accounts for both types of ownership. In the original position property should be subject to that form of ownership that minimizes the bargaining problems associated with moving the asset to its highest-valued use. In most cases that proposition points to a system of private property, where a *single* person enjoys the right to the possession, use, and disposition of a given thing. The existence of a single owner means that normally one person is needed to sell, and only one to buy. Stated otherwise, two distinct people are the logically necessary minimum for any exchange to take place. The system of private ownership tends to ensure that any two people who choose to pair up are able to so act, without the consent of others.

This concern with voluntary exchanges helps explain the original distribution of rights to the person and many forms of real and personal property. With the person, that result is achieved under the traditional protection of individual autonomy, long associated with natural rights theory. Each person is the sole owner of himself, and hence can sell his labor without the consent of other individuals. Autonomy quite literally means capable of movement by the self—alone. There is no need in this view to have any rule which specifies how any person acquires ownership of himself; he has it by being in necessary possession of his own body: "every man has a property in his own person; this nobody has any right to but himself. The labor of his body and the work of his hands we may say are properly his." (Locke, ch. 5, ¶27).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

No rule of original ownership for human talents could possibly operate at lower cost. Yet here too there are qualifications, for it is necessary to specify a guardian for individuals during infancy. Parents assume that role in part because they are in possession of the child at birth, and in addition have strong biological motives to protect the child until its maturity. The automatic selection of a very small number of guardians again facilitates the voluntary transactions entered into for the care and raising of the child.

With respect to land and chattels, there is no obvious assignment of any external things to any particular individual. In this context the first possession rule at common law allows persons to come forward and become single owners of external things (Epstein 1979). Once those things are reduced to single owners, they can then be disposed of in voluntary transactions that in the typical case involve two (or very few) persons. In both cases the distributional consequences of the first possession rule are distinctly secondary in importance. What matters is that resources with positive value not be left without any owners to fend for them, or with too many owners to squabble over them. In principle the entire process of assigning things to private ownership can take place, moreover, without the intervention of the extensive administrative state and its powers of centralized control. Initiation lies in the hands of private persons. The role of government is only to police the rules whereby ownership is acquired and transferred.

The desirability of this system of first possession changes radically when we consider, for example, the use of navigable rivers and lakes for transportation. Now any system of divided private ownership, based on first possession, tends to create the very bargaining and holdout problems that the institution of private property is designed to overcome. Each segment of the river is worth very little for transportation unless all segments could be subjected to uniform ownership. The risk is that the owner of one segment will hold out against all the others, so that bargaining breakdown will prevent any use of the river at all for navigation. It is precisely to overcome such difficulties that one of the most unproblematic uses of the eminent domain power has always been the condemnation of private lands for public highways, open to all. The formation of the highway removes, or at least controls, the risk of holdout which might otherwise dominate voluntary negotiations to lay out and construct roads.

If we need highways, then why is the land for public highways not owned by the public at large in the original position? The answer is quite simply this: while in the original position we know that there is some need for public highways, we do not know *where* they are

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

best located. That decision turns on subsequent events, including the pattern of land use development and the emerging routes for internal and external trade. The location of the highway involves some degree of discretion and must necessarily await future events. In the interim, private ownership of the underlying land facilitates its beneficial use. At some later time when the land is needed for the road, it can be condemned, where the requirement of compensation offers an effective way to constrain the state into making wise decisions about what lands should be taken (see Epstein 1985a, pp. 12–17).[2]

There is, however, no reason to wait for government action to dedicate navigable rivers to commerce. The location of the common highway is determined by nature. There is no need to begin with private ownership, and then to allow the property to be taken for public use upon payment of just compensation to private owners. So long as there is good reason to think that navigation along the river will be socially beneficial—an easy call—then the original recognition of navigation servitude prevents the blockade of the river by any single riparian or interloper. No system of eminent domain is costless to administer. Sometimes it is difficult to identify the owner of a particular asset; it is always tricky business to value their interests; and someone must levy and collect the taxes necessary to pay the needed compensation. The transactions costs are quite considerable. In contrast, the questions of which rivers are navigable, and what conduct counts as their obstruction can be answered by ordinary common law litigation. It is therefore possible to have a system of public ownership without an extensive government to administer it. The recognition of the public's navigation servitude in the original position ironically serves to *reduce* the size of government while recognizing the customary public ownership of public goods, which was firmly established if imperfectly justified.

There will of course be some difficult questions of how to define the limit of the scope of public ownership over navigable waters. The bilateral monopoly problem does not extend to all use of the

[2]Note in some cases cash compensation will not be needed, because the very presence of the highway will increase the value of the retained lands, so that each landowner's reduced holdings are worth more with the road in place than his larger holdings are worth without the road. Note too that the allocation of this surplus is nonetheless important. If there is no system of transfer payments after the highway is put in place, each owner will have an incentive to try to get the road located on the land of a neighbor, but adjacent to his own land. Requiring some fair division of the surplus created by the introduction of the road reduces this particular form of rent dissipation. In this context too there is a powerful correspondence between intuitive notions of fairness (that each person be treated equally) and the economic fear of rent dissipation.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

waterways (see Rose 1986, p. 749). There is no reason to adopt a system that speaks of some inherent right of public access to navigable waters over private riparian lands. While there may be only a single navigable river, there can be many places where access to that river can be gained. Competition between landowners will keep the price of entry down, and if public access points are desired, then individual landowners can be compensated for the loss of their exclusive possession. Unless that is done, each riparian will be prepared to undertake steps to influence government powers to place public access ways over the lands of others. Requiring compensation reduces the costs of these wasteful games, while at the same time public officials face a budget and a taxing constraint whenever they wish to expand the scope of access.

Issues like fishing and bathing in navigable rivers are closer calls (Rose 1986, pp. 754ff.), but in the end these, unlike access rights, should probably be regarded as public. Once there is a guaranteed access to the river in question, it is hardly conceivable to think of effective ways to prevent persons on the river from using it for these purposes, and not obvious to imagine how a principle of first possession could reduce fishing and bathing rights across the board to private ownership.[3] It is very difficult to exclude persons from using navigable waters when they cannot be excluded from gaining access to it. Navigable rivers are therefore a mixed asset, some of whose attributes should remain private and others should be public. In sorting out the various cases, the guiding principle throughout should remain constant: choose that form of ownership that minimizes the expected number of bargaining breakdowns. The historical divisions between public and private rights often followed that general rule.

Nor Shall Public Property Be Transferred to Private Use, Without Just Compensation

The parallels between public and private property can be extended to the second of our inquiries, the correction of individual allocative mistakes. In dealing with private property, the system of ownership created under the rule of first possession will not always prove optimal. To be sure, private bargains can often work the needed reassignment of property rights. Yet in other cases, when the bargains must touch the rights of multiple owners, the parties face the very set of bargaining barriers that private ownership was designed to

[3]This is not to say that some form of regulation by the state will not in the end be necessary. Common fisheries present the obvious and classical common pool problem (see Hardin 1968).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

avoid. The problems of the common fishery, of oil and gas, and even of bankruptcy are often taken as illustrations of cases where voluntary bargains are unable to correct allocative imbalances brought about in a system of private property based upon the principle of first possession.

In this world the use of government takings is thought to play an important role. The government takes property from private parties and pays them compensation, in cash or in kind, for what they have lost (Epstein 1985a, chaps. 14–15). The point of the system is that if the state can afford to pay the compensation for the losses that it imposes upon private owners, then there is good reason to believe that the entire set of coerced takings will benefit all (or virtually all) members of society simultaneously. The reason why compensation is strictly required is both prudential and universal. If takings could be made by state fiat alone, then, to avoid abuse, there would necessarily have to be elaborate administrative reviews to estimate, first, the value to the state of the property taken, and second, the losses the taking imposes upon the private owner. The taking should only go forward where the gains to the state (or the people it represents) exceed the losses that the taking imposes. But no administrative process is equal to that task. These investigations would be expensive to supervise, and in the end there would be little reason to have any confidence that only the "right" takings were undertaken by the state. The requirement of just compensation thus serves as an effective bulwark against government abuse by making public officials back up speech with dollars. Questions of the size of public gain are largely removed by judicial review, leaving the price feature as a powerful deterrent to unwise state action. If the court sets the price of the taking correctly, then there is some insistent legal pressure for public officials to estimate accurately the benefits from their own takings. Where the prices are set incorrectly (as when losses to good will are improperly ignored in the calculations), then there will be too many takings brought about by the state.

The analogous problem of correcting imbalances could also arise with property that is originally held by the public in common. Suppose some property which is given to the state is more valuable in private hands. The question is how does one determine what property that is, and transfer control over it to some private person. Initially the problem is complicated because property that has been customarily held in common cannot be disposed of by the (disorganized) public at large. Some group of persons must have the powe to dispose of it, and to control the use of the proceeds that has been so obtained. The need to transfer resources from state control is just

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

one reason why some organized system of collective ownership has been imposed upon public property. But whenever power is created, abuse may follow in its wake. The question is what rules, if any, should regulate those transactions that seek to move public property into private hands.

Two questions have to be addressed. The first is whether the transfer should be made, and the second is, when made, what level of compensation should be provided. The problem of disposing of public property thus raises the mirror image of public use and just compensation questions under the takings clause of the Fifth Amendment: "Nor shall private property be taken for public use, without just compensation." The underlying problems are not any simpler when dealing with property which was originally held by the public in common, for now the guiding principle is in a sense the converse of the original eminent domain clause, to wit: "No *public* property may be transferred to *private use*, without just compensation," payable to the public at large. This reverse eminent domain clause in turn reduces itself into the same two questions raised in the ordinary takings context, first, whether the state transfer should be made, and second, what compensation, if any, should be provided.

In dealing with the first of these issues, it is clear that the transfer is desirable only if it can improve the lot of everyone in society, that is, by the creation of general social improvement. In order for that conclusion to hold, there must be some reason to believe that the private owner of the asset can make better use of it than the public owner. In dealing with the navigation servitude over the river that conclusion does not seem very promising. Initially, any transfer of the navigable servitude to two or more persons, each entitled to do with his interest as he pleases, cannot have the desired effect, because it necessarily reintroduces the bilateral monopoly problems that the system of public ownership was designed to overcome.

In principle it might be possible to escape this problem by selling the navigation servitude to a single firm. But other problems remain. Surely the sale of the navigation rights limits the otherwise unlimited access to the public waters. In order to recoup the initial cost, the owner of the navigation servitude must charge a positive price to all users of the system—a price which will usually be in excess of the very low marginal cost that each additional user brings upon the system. And there would be a real skewing of benefits from privatization unless the new owner were required to accept *all* users at some nondiscriminatory price. The moment this condition of universal access is added, however, it becomes a doubtful question whether the navigation servitude has been really made private. The

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

insistence upon universal access impresses the public trust upon the navigation servitude even after legal ownership is vested in private hands. The absolute right to exclude, long thought the essence of private property, is denied the purchaser who takes, as it were, subject to the original public trust.

The theoretical gains from this type sale are, then, very hard to see. Yet its practical difficulties are very great. First, there are considerable costs associated with trying to organize a sale of so complex an asset as a navigable river. Who does the packaging of the rights and measures their value? Is it possible to really sell off the entire Mississippi river system from Minnesota to New Orleans? Unlike the case of highways, there is no obvious way to allow the new monopolist to limit the use of the river by riparian owners, who have previously had unlimited access to it. It is for good reason, then, that privatization has not come to the navigation servitude. The social gains just do not seem to be there.

At this point the parallels to the ordinary principles of eminent domain become explicit. When it is said that public rights over navigable waters are "inalienable," then the law in effect has applied by analogy the "public use" limitation of the ordinary eminent domain clause to property held by the public. If the transfer of the navigation servitude into private ownership *reduces* the levels of wealth (or utility), as seems likely here, then no system of side payments, no system of just compensation, can make all individuals better off than before when all gains and losses are taken into account. Someone has to bear the bottom line losses of the contemplated change in ownership rights. Under these circumstances, it is better therefore simply to prevent the transfer from taking place. Exactly that result is obtained by saying that public waterways are inalienable, and must remain, "inherently" public.

Yet in some situations, it seems clear that public ownership of resources is not necessarily a good thing. Consider the important case of minerals located in the riverbeds of navigable rivers. In the original position, it is arguably a close question of whether these should be treated as property held in common by the public at large, or as unowned resources subject to acquisition under the principle of first possession. On the one hand, private ownership of minerals does not create the same type of blockade situation that would arise with private ownership of a river or a lake. Yet by the same token, the removal of minerals from a riverbed may well require an extensive dislocation of transportation along the river, for surface easements are needed to mine. The dangers posed to navigation by unlimited private access to mineral rights over public waters are not

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

a trivial concern. Public ownership of the bed of the river and the mineral rights it contains avoids just that difficulty, and the general rule so provides (*Barney v. Keokuk*, 94 U.S. 324 [1876]).

Nonetheless it is doubtful that the public or the government has any natural advantage in the way in which it mines minerals. A system of ownership that treats the unorganized public as the owner of the minerals effectively withdraws them from gainful exploitation. The recognition that the state is the owner of these resources, in trust for the public at large, now endows a single group of individuals with the power to dispose of the minerals to private parties. The language of the public trust is far more than an idle metaphor because it is quite clear that the public officials in question cannot treat the proceeds of sale as their private property. Instead they are required to hold the moneys received as part of the public treasury, that is, for the benefit of all the individuals who had in the original position some undivided interests in the underlying mineral rights.

Some sales of public assets are for public benefit, but some are not. But which are which? Now attention has to be given to the question of what legal institutions will secure for members of the public at large the right price and the right terms for its asset. The first question raises the precise parallel to the "just compensation" requirement found in the eminent domain clause. If the transfer is simply made to private individuals without any restraint, there is the enormous temptation to use political influence and intrigue to divert public property to private hands. Requiring just compensation from the private acquirers of the mineral interests limits the possibility that the rights will be given away for a song, and strongly suggests that a competitive auction to maximize public revenues may be required as a constitutional matter.

This stringent compensation requirement, however, does not of itself answer the second question: What is the bundle of rights that the state itself should put up for auction? The problem is of great importance with minerals, where the structure of the access rights may alter the value of the navigation servitude that is retained. The pricing system is not able to handle this question because bids for the assets sold will not reflect the diminution in the value of the property rights retained by the public. Some form of administrative action is necessarily required. A division of power among various public officials is, accordingly, a necessary part of the program of any sale of public assets. That these additional steps are required should not be surprising. Private corporations often must confront the perils of self-dealing, and they take similar procedural precautions. If anything, the conflict of interest problem is far more acute with the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

disposition of publicly held assets. Unlike the corporation situation, there is no systematic selection of individuals into the public venture based upon their common attitude toward risk, or their attitudes on consumption. Still every member of the public is a beneficiary of the public trust. Their fundamental divergence of opinions and attitudes only makes it more difficult to decide whether, and if so how, these public assets should be disposed of. The procedural safeguards are as much a part of the program for the disposition of public assets as the just compensation requirement.

Illinois Central Railroad v. Illinois

The above framework should make it possible to explain the enormous intellectual difficulties in that most important of the public trust cases, *Illinois Central Railroad v. Illinois* (146 U.S. 387 [1892]). The history of the case should be recounted in some detail. An Illinois statute of 1852 had given the Illinois Central Railroad permission to construct a line along the shore of Lake Michigan. That original grant was then confirmed in a statute of 1869. More controversially, the 1869 statute also granted to the Illinois Central Railroad title to extensive submerged lands in Lake Michigan, about 1,000 acres in all, including all of the outer harbor along Lake Michigan, and some additional submerged lands as well (146 U.S. at 454). The new grant provided that the railroad should hold title to the land in perpetuity, but should not have the power to grant, sell, or convey the fee, that is, outright ownership, therein to any other person. The state retained no express power to revoke the grant. Illinois Central was given the same freedom of control over the lands as if they were uplands, that is, lands not subject to the original navigation servitude. The grant also provided that Illinois Central could not "authorize obstructions to the harbor or impair the public right of navigation, or exclude the legislature from regulating the rates of wharfage or dockage to be charged" (id. at 451). In exchange for the conveyance of the land, Illinois Central agreed to carry over the compensation formula that the 1852 act used to set the moneys payable by the railroad to the state, and to pay some fraction of its gross earnings from its use, occupation, and control of the submerged lands in question. The 1869 grant, however, did not oblige the railroad to enter into any immediate efforts to make improvements on the lands so conveyed.

The entire arrangement under the 1869 statute was short-lived, for the original grant was revoked by new legislation, without compensation, four years later. In the interim period the Illinois Central had used some but not all of the waters conveyed to it for its railroad

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

business, but did not appear to pay any revenues to the state. The challenge made to the 1873 act was, when all was said and done, that the revocation of the 1869 act was an illegal taking. The railroad's case was that the grant of the submerged lands had conveyed an indefeasible title in the railroad in accordance with the terms of the grant. At that point the state could still revoke, but only if it paid compensation for the property so taken. Once the state conveyance is made the private title is as good as that which is acquired from any other source.

The argument for the state was that its original conveyance was in violation of the public trust under which those submerged lands had been held. As such at most a mere license was created by the 1869 act, so that an asserted legal title in the railroad was void (or at least voidable) at the option of the state. The upshot was that no compensation was required when the new legislature reversed the field of the old one.

The decision in the case was close, but the state prevailed by a four to three vote.[4] The opinion for the Court was written by Justice Stephen J. Field, normally a staunch defender of individual liberty and private property. (See, e.g., his powerful dissent in *Munn v. Illinois* 94 U.S. 113 [1877]). His refusal to uphold the original legislative grant has been taken to be inconsistent with his general philosophical position. On reflection I believe this is a mistake. In order to understand the case, it is necessary to apply the two-step analysis of public trust cases developed above.

The first question is whether the conveyance to Illinois Central is per se out of bounds because it necessarily is a losing proposition. However, it is hardly clear that the case falls into this category. The 1869 statute did not convey the entire lake itself to a private party. The use of Lake Michigan for navigation remains unimpaired, and the development of the harbor is consistent with the original use of the lake itself, for the grant itself prevented the railroad from obstructing navigation. In addition, there may be some efficiency gains in integrating the operations of the shipping and rail traffic. Finally, the risks that the railroad will abuse its position are reduced given that the state reserved powers to regulate its activities on the submerged lands. A categorical denunciation of the grant is hard to establish.

The question therefore turns on the second of the two issues identified above: Did the state receive just compensation from the private

[4]Two justices were disqualified: Chief Justice Melville Fuller because he had represented the City of Chicago, and Justice Blatchford who was a shareholder in Illinois Central Railroad.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

party for the lands which it had conveyed out? In order to answer this question it is necessary to value the consideration received by the state for the submerged lands conveyed away.[5] By treating the question strictly as one of the capacity of the city to convey its submerged properties, Justice Field (and the dissent of Justice Shiras) did not explicitly address the compensation issue. But it is clear that this issue lies at the root of the case. Note, initially, there was no competitive bidding situation for the rights to the submerged land, and the price paid over was shrouded in mystery. Thus the 1869 statute called for the payment of $800,000 in installments to the city for the submerged lands, but the city comptroller refused to accept the first payment from the railroad if acceptance meant a waiver of the city's rights to challenge the grant. The remaining payments from the railroad were only conditional upon its receiving revenue from its development of the project in question. None (it appears) had been paid over in the interim four-year period that the statute had been in effect, and the railroad had complete control over the timing of any improvements that it chose to make. Clearly there are always conflicts of interest between the city and the railroad with the timing of improvements, and the 1869 act reduced the cost of delays to the railroad. Finally, the amount of land conveyed in the 1869 grant had been quite considerable in extent and value. It was as large as the docks along the Thames; much larger than those of Liverpool, and nearly as large as those of New York (id. at 454). The consideration for so substantial a grant should be quite considerable indeed.

In spite of its critical importance the just compensation issue was never addressed, except obliquely. Justice Field insisted that small grants of particular bits of waterfront for the development of piers and wharfs were well within the power of the state to grant. For this he was chided forcefully by the dissent of Justice Shiras, which said that if the state has the capacity to convey out bits and pieces of the waterfront, it could convey out the entire area at once. If the only issue had been the capacity to convey, then Shiras's objection would have seemed well grounded, but once the focus turns to the just

[5]There is also a second takings issue hidden in the case. If the moneys received by the "state" are paid into the state treasury, then there may well be an implicit transfer among citizens of the state. The citizens of Chicago are the obvious beneficiaries of the use of the submerged lands in Lake Michigan, but the proceeds of sale inure only in part to their benefit, with the remainder going to citizens downstate. The implicit wealth transfer between different segments of the public creates rent seeking opportunities. The public trust doctrine does not only address the opposition between the individual recipients of the trust property and the public at large, but also the parallel tensions between different members of the public. I shall, however, not pursue these issues further here.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

compensation requirement, then the reverse is true. It is easier to monitor whether the state is getting fair value if it sells off small parcels for immediate use by competitive bid. It is far harder to measure compensation with the giant deal that was organized here. The clear sense of the Court's majority was that the city had been "ripped off" by the railroad which had gotten the advantage of a bargain purchase under the 1869 statute. Once that is done, then only complete nullification of the original grant will set the situation aright. Condemning the lands back again only allows the railroad to cash out a gain to which it was not entitled in the first instance.

It might of course have been possible for the railroad to place a different gloss on these facts. The railroad, for example, could have tried to show that the city's retained power of regulation over its wharves and piers eliminates the dangers of monopoly profits, and that the percentage of future revenues reserved under the grant are substantial in character. And even if the railroad does not have perfect incentives to develop the property, it surely has some, for the longer it keeps the waterfront in its undeveloped state, the longer it has to wait to realize a return from its asset. In his argument, the railroad's lawyer made explicit reference to the fact that the common council of Chicago gave its consent "on conditions that were extremely burdensome, but they have been fully complied with" (id. at 416).

At this distance it is extremely difficult therefore to make a judgment about how the adequacy of consideration issue should be ultimately resolved. Yet when all is said and done there is no denying its relevance. Suppose a private corporation sold all its assets to one of its shareholders. The risk of self-dealing is so great that the transaction could always be challenged by the remaining shareholders on the ground that the corporation had not received adequate compensation for the property it had distributed. *Illinois Central Railroad* raises that same issue of self-dealing in the public sphere. When Justice Field struck down the grant to the railroad, he acted not to restrict the power of ordinary conveyances, but to prevent the abuse of legislative power that might well have transpired. His position is thus consistent with his own theory of limited government, which everywhere places limitations on public officials that are not imposed upon private individuals.

Notwithstanding the internal logic of Field's opinion, there are many disquieting elements about *Illinois Central,* both at an institutional and a constitutional level. As an institutional matter, it is surely a source of some disquiet that the case was finally resolved only 19 years after the 1873 statute. That delay works in no one's interest, for in the interim neither the city nor the railroad knows whether it is in a position to develop the land. The time to resolve

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

doubts about public grants is before, or shortly after, they are made. In part this can be done by procedural protections. Public hearings about the terms and conditions of the grant, its costs and its benefits, seem clearly appropriate before the grant is made. Such deliberations are held before corporations sell substantial assets to shareholders.

There is, however, no certainty that these will be sufficient. The question therefore is what types of judicial challenges can be made to set aside the grant. *Illinois Central* reached the courts only because the subsequent legislature revoked the earlier grant, without paying compensation. But why should the grant remain beyond challenge if it is not revoked? The underlying fear is both familiar and recurrent: the first legislature has been bought off. If so, then the next legislature could be bought off as well. To condition challenge to the grant on its repeal means that in some cases needed challenges will never take place. *Any* citizen should have standing to challenge a major transfer of public assets. What seems to be called for is a system which allows a prompt (if that word can ever be used about the judicial system) challenge to the original grant on grounds of inadequacy, as by declaratory judgment. But the fuse should be short, and once the period has passed, the grant should be regarded as fully valid, and not subject to subsequent attack in any forum. Its future revocation would then require compensation.

Constitutional Issues

The constitutional issues raised by *Illinois Central* are, if anything, more puzzling. The public trust doctrine is the mirror image of the eminent domain clause. Both are designed to place limitations upon the power of legislature to divert property, whether held privately or in common, from A to B, or more generally from a group of As to a group of Bs. Both doctrines derive from a strong sense of equity that condemns these uncompensated transfers as a genteel form of theft, regardless of whether the original holdings are public or private. In each case the prohibition upon legislative behavior has beneficial allocative consequences as well, because it prevents the dissipation of valuable resources that are used to obtain or resist uncompensated transfers. In principle the public trust doctrine should operate at the constitutional level, as a parallel to the eminent domain clause. Nonetheless the basis for the public trust doctrine in the United States Constitution is difficult to identify.[6]

[6]Many state constitutions have specific public trust provisions in them. See, e.g., Montana Constitution, Art. 9, §3(3), which provides:

> All surface, underground, flood and atmospheric waters within the boundaries of the state are the property of the state for the use of its people and subject to appropriation for beneficial uses as provided by law.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Consider the way the public trust question arose in *Illinois Central.* That action was brought by the railroad to challenge the revocation of the original grant under the 1873 statute. The railroad claimed that the earlier conveyance had made the submerged lands its private property, protected against the confiscation by any government action. If the railroad did indeed own the lands, then its case was airtight. Accordingly the state's defense rested on the proposition that the original grant was invalid under the public trust doctine. The public trust question was thus raised by indirection only. At this point, the juridical status of the public trust doctrine in the legal hierarchy becomes critical to the analysis. If the doctrine applied only at common law, then the state legislature could trump it. If the principle were embodied only in the Illinois constitution, then the case should not be heard in the U.S. Supreme Court. If the public trust principle found its application in the U.S. Constitution, then Justice Field should have said where. But the opinion is not "clause-bound" (see Ely 1980) in any sense at all. Instead Field works very much in the "natural" or "higher" law tradition (see Grant 1931). *Illinois Central* contains no citations to particular constitutional provision, and the opinion reads like an essay that runs for 20 pages without case citation (146 U.S., at 436 to 456).

It is therefore an open question whether the public trust doctrine has a constitutional home. Here two alternatives present themselves, each with its own interpretative difficulties. The first is the standard due process clause of the Fourteenth Amendment: "Nor shall any State deprive any person of life, liberty, or property, without due process of law." There is a long but an uneasy tradition that reads the last phrase, "without due process of law" to be the equivalent of "without just compensation" *(Chicago, Burlington & Quincy Railroad Co. v. Chicago,* 166 U.S. 226, 236 [1896]). On that substantive reading, the due process clause seems to apply because the "property" to which it refers includes not only private property, but also the fractional share that each person holds in the trust property. At this point the outcome in *Illinois Central* depends upon the adequacy of consideration received by the state, just as this due process analysis appears to provide.

The second possible source of constitutional rights is the equal protection clause, which provides that no state shall "deny any person within its jurisdiction the equal protection of the laws." Unlike the due process clause, this clause is not tied to the protection of any particular interest in property, public or private. The modern law of equal protection confers upon the states a massive degree of discretion for dealing with property and other economic issues *(Minnesota*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

v. Clover Leaf Creamery Co., 449 U.S. 456 [1981]) because such is not regarded as either a "fundamental right" like voting (*Harper v. Virginia State Board of Elections*, 383 U.S. 663 [1966]); or a "suspect classification" like race (see *Brown v. Board of Education*, 347 U.S. 483 [1954]). Neither gloss on the clause, however, appears to be compelled by the text, or even consistent with its general language. The principle of equal protection is stated in universal terms: *no state* shall deny *any person* equal protection of the laws. Accordingly the clause seems to prohibit any invidious classification that the state makes among its citizens, wholly without regard to fundamental right or suspect classification.

Viewed in this expanded light, the public trust cases appear to fall under the clause. When property is conveyed out of public trust for inadequate consideration, some citizens receive disproportionate benefits, while others receive disproportionate losses. The uncompensated transfer of public property to private use thus disadvantages some at the expense of others. Those who have come up short under the transfer have been denied the equal protection of the law. Success or failure under the equal protection clause thus turns on the presence or absence of compensation when property rights are taken. This close connection between disproportionate impact and just compensation is not simply invented for the occasion. It is quite explicit in the ordinary eminent domain cases. "The Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole" (*Armstrong v. United States*, 364 U.S. 40, 49 [1960]; Epstein 1985a, pp. 204–9). This "equal protection" dimension of the eminent domain problem arises with equal force in the public trust cases as well. The net losers under the transfer have not received equal protection of the law.

Conclusion

The preceding discussion has examined the public trust doctrine in the area of its birth. In closing it is worth asking how far the doctrine can be extended. From the above arguments the scope should be broad indeed. So long as one deals with property which is held by the people in common in the original position, then its disposition is governed by the public trust doctrine as formulated in *Illinois Central*. Some sense of the sweep of the doctrine is captured by

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Professor Sax (1970, p. 566) in his early and influential treatment of the subject:

> It is clear that the judicial techniques developed in public trust cases need not be limited either to these few conventional interests [e.g. rivers, streams or parklands] or to questions of disposition of public properties. Public trust problems are found whenever governmental regulation comes into question, and they occur in a wide range of situations in which diffuse public interests need protection against tightly organized groups with clear and immediate goals.[7]

The source of the danger is evident. Well-organized political groups may well be able to obtain net transfers from legislation. As such the connection between the defects of the political process and the public trust doctrine is as explicit as the connection between the defects of the political process and the eminent domain clause (Epstein 1985a). As the takings clause, in my view, reaches all forms of taxation and regulation, it should not be surprising that the public trust doctrine has a similar scope.

The closeness of the public trust doctrine and the eminent domain power can be shown in yet another way. Thus far the inquiry has taken place on the assumption that all property held by the public was acquired by it in the original position. That assumption is clearly false in the modern setting, where enormous amounts of property held on the public account have been acquired by either purchase (with tax dollars) or condemnation. With respect to property so acquired the eminent domain principle and the public trust principle now converge. The two principles impose identical limitations on the disposition that public officials can make of public property. The nature of the limitations could be quite substantial, and it might be appropriate in closing to mention a few illustrations of their reach. Assume that land has been condemned for use as a public highway. If it is thereafter held in public trust, then it is highly questionable whether the state may allow some individuals free access to the highways which it denies to others. There is thus serious doubt as to whether the state can issue licenses for commercial transportation to some firms, while denying those licenses to others. At the very least it should be required to sell those licenses in a competitive market, so that the gain from the license remains with the public at large. The elaborate prerogatives of licensing bus and taxi services on a favored basis is more than nettlesome. It is an impermissible diversion of public assets to some persons to the exclusion of others.

[7]Sax then adds rights of way for utilities, wetland regulation, and air pollution to the list of questions. But the comprehensive scope of the theory goes further.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The same point of course applies with respect to exclusive franchises over public waters. The great case of *Gibbons v. Ogden* (22 U.S. [9 Wheat.] 1 [1824]), for example, involved a grant by the state of New York to Livingston and Fulton of the exclusive right to run steamships in New York Harbor. The grant was held to be invalid because it was preempted by federal statutes enacted pursuant to the power of Congress to regulate commerce among the several states. If the analysis above is correct, exclusive grants of that sort are improper diversions of public resources under the public trust, even if authorized by Congress. There is little reason to believe that a system of monopoly control promises superior social results to one of free entry, and in any event, there was no evidence that Livingston and Fulton paid full value for the franchise that they so acquired.

Over a broad range of cases, then, the public trust and the eminent domain theory impose in principle parallel restrictions upon the application of government power, no matter what the original distribution of rights. This is as it should be, for a comprehensive theory of governance should be able to account for all forms of government control of property, regardless of whether that property is public or private in the original position.

References

Ely, John Hart. *Democracy and Distrust: A Theory of Judicial Review*. Cambridge: Harvard University Press, 1980.

Epstein, Richard A. "Possession as the Root of Title." *Georgia Law Review* 13 (1979): 1221–43.

Epstein, Richard A. *Takings: Private Property and the Power of Eminent Domain*. Cambridge: Harvard University Press, 1985a.

Epstein, Richard. "Why Restrain Alienation?" *Columbia Law Review* 85 (1985b): 970–90.

Epstein, Richard A. "An Outline of *Takings*." *Miami Law Review* 41 (1986): 3–19.

Grant, J. A. C. "The 'Higher Law' Background of the Law of Eminent Domain." *Wisconsin Law Review* 6 (1931): 67–85.

Hardin, Garett. "The Tragedy of the Commons." *Science* 162 (1968): 1243–48.

Holderness, Clifford. "A Legal Foundation for Exchange." *Journal of Legal Studies* 14 (1985): 321–44.

Locke, John. *Of Civil Government, Second Treatise* (1690).

Rose, Carol. "The Comedy of the Commons: Custom, Commerce, and Inherently Public Property." *University of Chicago Law Review* 53 (1986): 711–81.

Sax, Joseph. "The Public Trust Doctrine in Natural Resource Law: Effective Judicial Intervention." *Michigan Law Review* 68 (1970): 471–566.

Sax, Joseph. "Liberating the Public Trust Doctrine from its Historical Shackles." In *The Public Trust Doctrine in Natural Resources Law and Management*. Edited by Harrison C. Dunning. 1981.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Rent Seeking and Rent Dissipation: A Critical View

Marilyn R. Flowers

Introduction

The developing literature on rent seeking has added a new dimension to measurement of the welfare cost of government redistributive activity, particularly that which emerges in the form of restrictions on market competition. The simplest model of rent seeking, and the one most commonly employed, hypothesizes that any artificially contrived rents will be competed away by parties seeking to secure a share of such rents. To the extent that this competition employs real resources, these resources are wasted, and their cost must be added to the standard welfare triangle as a measure of the deadweight loss resulting from government action. In the simple competitive rent-seeking model, all potential rents are dissipated.[1]

One implication of the competitive rent-seeking model is that *no one* gains from the relevant government action. From a public choice perspective, this seems a puzzling result. Why does the political process tolerate institutions that prevent it from performing what arguably is its primary function, that of redistributing income or wealth from some groups to other groups? Alternatively, are such institutions actually as pervasive as some of the general discussions of rent seeking suggest? The assumption of complete dissipation has been used to provide the basis for empirical estimates of rent-seeking

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.

The author is Associate Professor of Economics at the University of Oklahoma. She thanks James Buchanan for his helpful comments on an earlier version of the paper. The usual caveat applies.

[1]See Tullock (1980) for a critique of the hypothesis that competitive rent seeking will exactly dissipate rents. He offers examples in which the resources devoted to rent seeking can be either less than or possibly greater than the initial rents created by government policy. However, this analysis is not directly relevant to the issues discussed in this paper and, therefore, will be ignored.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

costs.[2] A theme of this paper is that such an approach is questionable. Various factors will be examined that would seem to limit the potential for rent dissipation. At the very least, there seems to be a need for careful case studies to provide an empirical basis for generalizations about the costs of rent seeking.

Examination of the potential for waste resulting from rent seeking can be divided into some broad categories. An important distinction can be made between rent-seeking activities devoted to securing favorable legislation to create rent and those activities devoted to allocating shares of such rent once it has been created. There also would appear to be significant differences between rents that emerge as a result of government restrictions on market output and government redistributive activity emerging directly from the tax-transfer process. These issues are examined below.

Rent Creation versus Rent Allocation

Edgar Browning (1974) has correctly identified a critical distinction between rent creation and rent allocation in terms of the incentives for affected parties to invest resources in pursuit of a favorable outcome. Passage of legislation that makes possible the emergence of rent in a particular market is a type of collective consumption good in the sense that multiple parties will have potential access to shares of that rent. It follows that the free-rider problem will limit the parties' willingness to invest in lobbying and other types of activities to secure the relevant government action. Once created, however, rent is divisible, which suggests that the social waste associated with rent seeking is probably more serious when the issue is rent allocation as opposed to rent creation.[3]

Another consideration, which perhaps has not been sufficiently appreciated, is that the willingness of potential individual beneficiaries to invest in rent seeking at the creation as opposed to the allocation phase of the process depends on their expected share of such rents once created. If final allocation is fairly assured, as, for example, restrictions on foreign competition to the benefit of domes-

[2]See, for example, Krueger (1974) and Posner (1975).

[3]Browning acknowledges that some care must be used interpreting the limitations imposed by the collective consumption characteristic of rent creation. Lobbyists abound in every legislative environment, and much of their activity is devoted to the creation of new rent, thus suggesting that the free-rider problem does not preclude some investment in procurement of nonexcludable public goods. The free-rider problem predicts underinvestment relative to potential benefits, not zero investment. Browning recounts the trenchant analysis of Mancur Olson (1965) as a primary explanation of the existence of some lobbying for collective benefits.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

tic producers, it seems more likely that individual domestic producers will contribute than if there is a general perception among members of the potential beneficiary group that further investment will be required at the allocation phase to garner a share. This suggests that a higher proportion of government rent creation will be of the sort that will not necessitate rent seeking at the allocation phase.

Some final points can be raised about rent seeking at the creation phase that are more or less independent of free-rider considerations. Rents are dissipated in the competitive model because of free entry into competition for fixed total rents. This description is well-suited to the problem of rent allocation but seems inappropriate for rent creation. The competitive model might be relevant if the government had limited total rents available to allocate, as, for example, if limitations on competition in the auto industry had to be achieved at the expense of forgone rents granted to the airline industry. However, this does not seem empirically relevant.

Examination of the demand for government rent-creation activity suggests that the effective demand expressed in the political marketplace probably understates true willingness to pay. Other issues relevant to the dissipation hypothesis can be raised with respect to the supply side. One way of framing the issue here is to ask whether it seems plausible that politicians—the "suppliers" of such rents—will be able to fully exploit whatever effective demand exists in the sense of extracting the maximum of expressed willingness to pay for their services.

Some contributors to the rent-seeking literature have suggested a model of supply-side dissipation of rent in which politicians are able to extract payments for their services. The rewards to a successful political career are correspondingly increased and rents are dissipated by competition among politicians for the limited number of elective offices.[4] This hypothesis suggests some rather unusual implicit assumptions about the nature of the political process and specifically about political competition. A presumption that politicians can appropriate all rents they create ignores both the demand-side problems discussed earlier and also seems to assume that political entrepreneurs are able to make all-or-nothing offers or otherwise engage in perfect price discrimination in order to capture all of the political surplus. Behavior of this type generally is associated with the absence of competition in the private marketplace. In the political marketplace, one must ask why competing political entrepreneurs do not engage in price competition? Why would politicians compete by

[4]See Tullock (1975, pp. 675–76) and Tollison (1982, pp. 578–79).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

charging high prices for their services and expending the revenue (wastefully?) to capture public office rather than simply lowering the prices charged for their services? Incentives for price competition seem strengthened when one considers that an existing group of elected representatives may be competing among themselves for payment from those seeking favorable legislation. This is because only a simple majority of their votes need be purchased. If the potential buyers of a government favor have succeeded in organizing a single bargaining unit through a trade association or similar group, they may have a distinct advantage in negotiating with competing sellers of votes.

Rent Allocation and Property Rights

Suppose that the government has decided to limit the number of widgets sold to 100 per week and that this quantity is 30 widgets fewer than the number of widgets that would be produced and sold in an unrestricted market. Rent has been created, and at issue is the allocation of that rent among competing widget producers. As noted previously, this rent is divisible. Producer A's right to produce one more widget must be obtained at the expense of some other producer who loses the right to produce that widget. Correspondingly, competition for limited production rights may occur uninhibited by free-rider considerations, and any resources expended in this competitive process constitute social waste, which is at the heart of the rent-seeking literature.

The extent to which pursuit of the artificially contrived rent results in social waste depends critically on the nature of the institutions that allocate the rent. If the scarcity rights were directly auctioned, no deadweight loss beyond the traditional welfare triangle would be incurred except for the presumably minor costs associated with administering the auction. The taxpayers at large would capture the rent as opposed to producers. There is, of course, the possibility that the availability of the added government revenue will itself give rise to rent seeking by potential beneficiaries of government spending programs or tax reductions.[5] Rent seeking at this secondary level, however, seems likely to be constrained by the same factors that constrain rent creation and will be ignored for the remainder of this paper.

The direct auction is rarely observed. It is, however, not the only institutional arrangement that avoids wasteful rent dissipation. Alter-

[5]See Buchanan (1980) for a discussion of the auction problem.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

native methods are available, and their use in the examples discussed below suggests that the deadweight loss associated with allocational rent seeking may not be as large as the traditional rent-seeking literature suggests.

An obvious alternative to the direct auction is an implicit auction resulting from the capitalization of rent into asset values. For example, limitations on entry into the taxicab market in New York City are capitalized into the price of medallions, which represent the license to operate in that market. Similarly, Coase (1959, p. 22) argued that the monopoly rents made possible by the Federal Communication Commission's limitations on entry into the commercial broadcast market were effectively capitalized into the value of the capital assets of existing stations:

> [P]art of the extremely high return on the capital invested in certain radio and television stations has undoubtedly been due to this failure to charge for the use of the frequency. . . . Strictly, of course, all that can be sold is the station and its organization; the frequency is public property, and the grant of a license gives no rights of any sort to that frequency. . . . However, the [Federal Communications] Commission almost always approves such negotiated transfers, and when these take place, there can be little doubt that often a great part of the purchase price is, in fact, payment for obtaining the use of the frequency.

Other examples can be cited. Licenses granted by the Interstate Commerce Commission to provide common carrier service between specific locations often were not used by their owners directly. Rather, the owners rented the rights to other firms. Tobacco price supports are maintained by the Department of Agriculture's designation of specific acreages that can be used for tobacco growing, and substantial penalties are imposed on tobacco grown on other land. Rents are correspondingly capitalized into land prices.

In the examples cited, marketable property rights have been effectively established for the scarcity rents created by government policy. Several issues can be raised with respect to the rent-seeking implications of this phenomenon. First, that which the government giveth can also be taken away. To what extent must the holders of assets exhibiting policy-enhanced value invest resources to protect that value? Two groups have the incentive to seek policy changes detrimental to current recipients of artificially contrived rent—consumers and potential (as opposed to actual) producers. In both cases, if the option available to the group is a general change in policy, the context is one of rent creation (or destruction, in the case of consumers), and their efforts should be correspondingly limited for reasons discussed

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

earlier. On purely empirical grounds, it should be noted that a perceived necessity on the part of current holders of the assets in question to invest resources to protect the value of those assets should limit the extent to which capitalization of rents will occur. Positive capitalization can be taken as evidence that current dissipation of rents is not total.

There remains the possibility that rent seeking occurred when the government established the policy that led to the emergence of marketable property rights. What resources were expended to influence the initial allocation of taxi medallions, broadcast licenses, and the like? Some have suggested that this phase of the process is the one to be examined for evidence of rent dissipation. Resources equal to the present value of the expected future stream of rents could have been invested to influence the initial allocation.[6] Casual evidence does not support this hypothesis. Taxi medallions in New York City, for example, were initially granted to all cabs operating at the time the policy was established. Rent emerged over time because new medallions were not granted in response to growing demand.[7] Similarly, designated acreage for the tobacco support program is simply a proportion of those acres that were devoted to tobacco cultivation when price supports were established.[8]

These observations are consistent with the point made above that the willingness of a group's individual members to invest in rent seeking at the creation phase is positively affected by the degree of certainty relating to their own shares of the rent once created. One suspects that many of these policies developed as attempts to benefit existing producers at the relevant point in time to the detriment of potential future producers. This interpretation is also consistent with frequent observations that politicians have short time horizons. Institutions that allow expected future rents to be capitalized into asset values concentrate the benefits of rent-creating policies on those constituents extant at the time the policies are established.

Farm price supports would seem to provide additional examples of institutions that limit the dissipation of rents created by government policy. Government purchases of any excess supply at the support price eliminate direct allocational problems. The reason is, of course, that such a policy, taken by itself, does not impose an

[6]This point is made in a slightly different context in McCormick, Shughart, and Tollison (1984).

[7]For a historical discussion of the emergence of the medallion system in New York City, see Vidich (1976).

[8]For a discussion of the history of federal tobacco programs, see Johnson (1984).

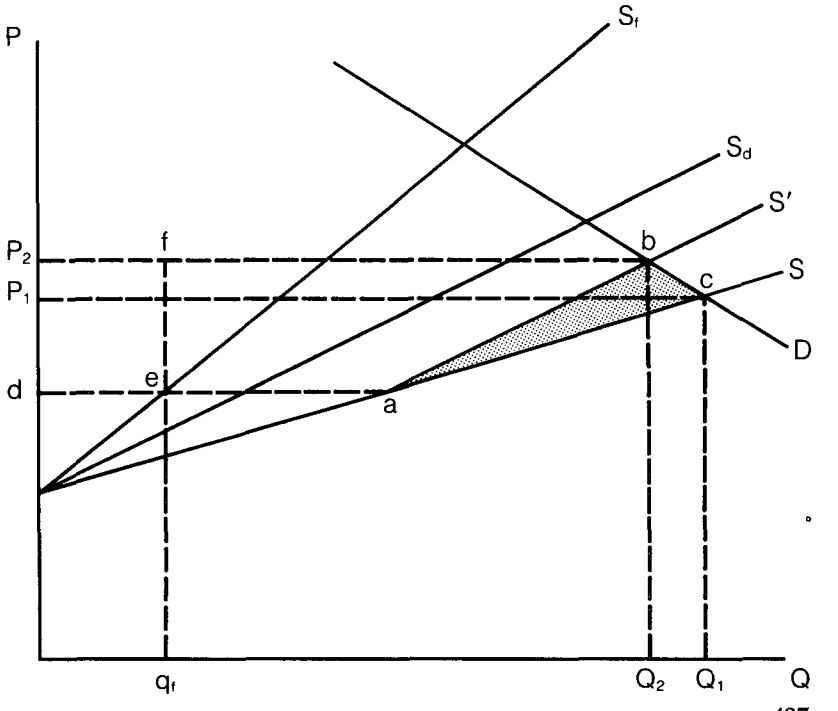
LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

artificial restriction on output. Attempts to restrain output generally have accompanied price supports, primarily to protect the government from the embarrassment of accumulating large stores of agricultural commodities. These restrictions, however, have primarily taken the form of financial incentives to farmers to hold land out of cultivation. Such use of a price mechanism significantly limits the potential for wasteful allocational rent seeking.

Restrictions on foreign trade provide an example of government rent creation in which allocation of the resultant rent is more or less determined by the nature of the restrictions imposed in the market. If an import quota or tariff is imposed, for example, the normal process of the market can still determine the allocation of production among domestic producers. The object of the legislation is simply to limit the market share going to foreign competitors. That the potential for wasteful allocational rent seeking is sharply limited in this case can be illustrated using Figure 1.

FIGURE 1

LIMITS TO WASTEFUL ALLOCATIONAL RENT SEEKING



LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Suppose that Figure 1 represents the domestic market for widgets. Domestic demand is indicated by D, and total supply in the absence of government intervention, S, is the horizontal summation of foreign supply, S_f, and domestic supply, S_d. The unrestricted market equilibrium is characterized by price and quantity of P_1 and Q_1, respectively. If an import quota, q_f, is imposed, the market supply curve becomes S'. Market equilibrium price and quantity rise and fall respectively to P_2 and Q_2. The standard (that is, nonrent-seeking) excess burden from this policy is the shaded triangle *abc*, which results from lost consumer surplus and inefficient production due to the exclusion of low-cost producers. The potential for loss resulting from allocational rent seeking is limited to the additional rectangle defP_2. This is less than the actual increment in producers' surplus of dabP_2 created by the policy.[9]

The examples cited suggest that institutional arrangements often do avoid dissipation of rent at the allocation phase. In the first set of cases, rents were capitalized into marketable asset values, thus making possible an implicit auction of the artificial scarcity rights created by government policy. In the foreign trade example, rent seeking was confined to foreign producers who are not direct clients of domestic politicians. Agricultural production restrictions generated by financial incentives provide yet another example of allocational arrangements that avoid competitive dissipation of rent.

Rent Seeking and Entitlements

The focus of concern thus far has been on government redistributive activity that takes the form of restrictions on normal market processes. Government also engages in more direct redistribution through the tax-transfer process. Incentives for rent seeking at the creation phase are basically the same regardless of whether the transfer being pursued is through market intervention or the grant of a direct transfer or subsidy from the "fisc." At the allocation phase, however, the incentives are very different. The rents available through market restrictions are limited, whereas transfers are generally open-ended entitlements available to any parties who meet legislatively determined eligibility requirements. The open-ended nature of entitlements eliminates the necessity for potential recipients to compete among themselves for available benefits. Thus, an important source of incentive for wasteful rent seeking is eliminated.

[9]It is worth noting with respect to this example that any losses associated with allocational rent seeking will not come at the expense of domestic GNP and correspondingly are probably not of concern to domestic politicians.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

There is one situation in which the rent-seeking model might be applicable to entitlements. If the government is interested in controlling outlays for a program, costs may be imposed on potential recipients to discourage their participation in the program. Examples might be excessive record-keeping requirements for tax preferences and delays and queuing required for welfare recipients to have their applications processed. These may be examples of the political process compromising between the objective of providing transfer programs but simultaneously trying to conserve actual outlays.

Conclusion

It would be puzzling from a public choice perspective if the political process generally tolerated dissipation of the redistributional gains, which are the primary product that politicians offer voters. The discussion in this paper is suggestive, though by no means conclusive, of a proposition that institutional arrangements often do emerge that avoid the dissipation of policy-created (as opposed to market-created) rents.

In considering what factors might influence the choice of institutions to allocate rent, an analogy with nonprice rationing in a market subject to a price ceiling is useful. Wasteful allocation mechanisms emerge in such markets because sellers, who ultimately must allocate the commodity, are legally prevented from capturing any of the potential gains available from efficient allocation. They are not rewarded for considering the interests of buyers, and presumably their choices are influenced by a desire to minimize the transactions costs associated with allocation that they must bear. In the political arena, politicians or their agents, regulators, have responsibility for determining the allocation mechanism for policy-created rent. As in the price control example, the most efficient allocative institution, direct auction, is not a relevant possibility. However, unlike that example, those responsible for determining the allocative rules have an interest in the procedure other than simply minimizing the costs imposed on themselves. If votes are to be won, there must be gainers. If votes are the relevant currency of politics, institutional arrangements which deliver that currency should be expected to emerge. This, in turn, would seem to favor institutions that avoid the complete dissipation of rent.

References

Browning, Edgar. "On the Welfare Cost of Transfers." *Kyklos* 2 (April 1974): 378–81.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Buchanan, James M. "Rent-Seeking and Profit-Seeking." In *Toward a Theory of the Rent-Seeking Society*, pp. 3–14. Edited by James Buchanan, Robert Tollison, and Gordon Tullock. College Station: Texas A & M University Press, 1980.

Coase, Ronald H. "The Federal Communications Commission." *Journal of Law and Economics* 2 (October 1959): 1–40.

Johnson, Paul R. *The Economics of the Tobacco Industry*. New York: Praeger, 1984.

Krueger, Anne O. "The Political Economy of the Rent-Seeking Society." *American Economic Review* 64 (June 1974): 291–303.

McCormick, Robert; Shughart, William; and Tollison, Robert. "The Disinterest in Deregulation." *American Economic Review* 74 (1984): 1075–89.

Olson, Mancur. *The Logic of Collective Action*. Cambridge: Cambridge University Press, 1965.

Posner, Richard. "The Social Cost of Monopoly and Regulation." *Journal of Political Economy* 83 (August 1975): 807–27.

Tollison, Robert D. "Rent Seeking: A Survey." *Kyklos* 35 (1982): 575–602.

Tullock, Gordon. "The Transitional Gains Trap." *Bell Journal of Economics* 6 (Autumn 1975): 671–78.

Tullock, Gordon. "Efficient Rent-Seeking." In *Toward a Theory of the Rent-Seeking Society*, pp. 97–112. Edited by James Buchanan, Robert Tollison, and Gordon Tullock. College Station: Texas A & M University Press, 1980.

Vidich, Charles. *The New York Cab Driver and His Fare*. Cambridge: Shenkman Publishers, 1976.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Regulation of Insider Trading: Rethinking SEC Policy Rules

William A. Kelly, Jr., Clark Nardinelli, and Myles S. Wallace

Introduction

The $100 million fine levied by the Securities and Exchange Commission (SEC) against Wall Street trader Ivan Boesky is the most spectacular development in the recent crackdown on insider trading. The regulation of insider trading is apparently becoming an increasingly important part of the SEC's regulatory activities. The Commission has stepped up domestic enforcement of the ban on insider trading and has attempted to limit the use of overseas exchanges to consummate insider trading in American securities (*Wall Street Journal,* 24 September 1986, p. 2). Although the effectiveness of the current crackdown cannot yet be determined, the Boesky fine, and other severe penalties that have emerged from the ongoing investigation of the insider trading ring centered around investment banker David Levine, signal the determination of the SEC to significantly curtail illegal insider trading. Although the current increase in regulatory fervor may die out to be replaced by a policy of benign neglect, in the short run it is highly likely that the SEC will succeed in reducing the amount of insider trading. The desirability of such a decrease, however, is questionable for many reasons.

One reason is that the support of the general public for a continued ban on insider trading is quite superficial. In a recent poll in *Business Week* (23 August 1986, p. 74), 52 percent agreed that insider trading should continue to be illegal. Yet, 53 percent of those polled would buy stock based on a tip from a friend who has inside information. Of those who would not buy the stock, 37 percent stated that the reason for not purchasing was that the tip might be wrong. About

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.

The authors are, respectively, Associate Professor of Finance, Assistant Professor of Economics, and Professor of Economics at Clemson University.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

half of those who would not trade on insider information cited illegality or immorality as the reason. In sum, the poll indicates that approximately 70 percent of the public would in fact trade on insider information if they found it profitable to do so.[1] Clearly, insider trading does not induce the same opprobrium as embezzlement or fraud.

Academics share the public's ambivalence toward trading on insider information. Although discussions in the popular press imply that insider trading is universally regarded as bad and appropriately illegal, the issue is anything but settled in the academic literature. For example, Henry Manne's (1966) analysis is the classic statement of why allowing insider trading is an efficient method of compensating entrepreneurs. Manne (1970, 1985) and others have subsequently bolstered the case for efficiency by citing the lack of hostility in the attitude of firms toward trading by insiders. In particular, the argument that the shareholders of firms are harmed by the trading of executives is difficult to reconcile with the absence of widespread private restrictions on insider behavior. Few firms restrict insider trading beyond what is required by the SEC (Dooley 1980; Easterbrook 1981). Moreover, the common law has permitted insider trading, except in cases involving fraud. The behavior of different political units provides further evidence that insider trading does little to harm investors or firms. States, who effectively compete for incorporations, do not appear to gain any competitive advantage over one another by prohibiting insider trading (Carlton and Fischel 1983; Easterbrook and Fischel 1984). Other countries for the most part do not vigorously regulate insider trading (Rider and Ffrench 1979), although recent developments on the London Stock Exchange appear to be leading to tougher rules against the practice.

The academic literature implies that the case for regulation is not overwhelming. Because insider trading moves the market prices of stock in the correct direction, it can be defended on grounds of efficiency. Arguments can be made that inefficiencies may arise due to withholding information or the moral hazard problem, but most economists find the case that insider trading is efficient to be stronger than the case that it is not (Carlton and Fischel 1983). Another justification for regulation is that it protects the property rights of the firm in inside information (Scott 1980). The property rights argument does

[1]That is to say, 53 percent of the public would buy stock on inside information. Of those who would not buy on inside information (47 percent), 37 percent apparently would buy if they thought the information was correct. Hence, 53 percent + (47 × 37) percent = 70.4 percent would buy on inside information if they believed they would profit from it.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

not necessarily mean that the SEC should regulate insider trading. Furthermore, it is seldom used by supporters of regulation. Most of the opposition to insider trading rests on grounds of fairness. It is argued that investors with insider information possess an unfair advantage over other investors. The prohibition of insider trading is thus deemed necessary to keep the game fair. As with a gambling casino, the odds in the stock market must be made the same for all players. Moreover, if some players regard the game as unfair, they may refuse to invest. The casino analogy may be an attractive way to view the stock market. The SEC nevertheless faces enormous difficulties in any attempt to realize the ideal of a stock market where no one benefits from inside information. The difficulties stem from the many different ways to profit from inside information. Here, we focus on some of the distortions caused by the current partial policing of insider trading.

The Gains from Inside Information

The insider trading that receives most public attention involves information of the "bombshell" variety: mergers, hostile takeovers, and mineral discoveries (Carlton and Fischel 1983). The classic case is that of *SEC v. Texas Gulf Sulphur Co.*, where insiders traded on the knowledge of mineral discoveries before those discoveries were announced to the general public. Recent well-publicized cases have involved stock purchases by speculators on the eve of a takeover. The importance of bombshell inside information has often obscured the fact that gains from insider trading are simply the most publicly visible of the gains from insider trading. Investors with access to inside information make above average returns in other ways.

One source of insider gains is trading on the basis of ordinary insider information. Ordinary information could include inside knowledge of the ability of managers. For example, an executive might know that a new chief executive officer is extraordinarily competent and buy stock on that knowledge, gaining from the appreciation brought about by the new boss. A feud between two important corporate officers could lead to gains to insiders who sell on the expectation that the feud will affect the firm's performance. Countless other bits of information can be used by insiders to outperform the market. Gains from ordinary inside information are not as spectacular as those arising from advance information on a hostile takeover bid. Yet, the aggregate gains from ordinary insider trading may well exceed gains from the more glamorous bombshell trades.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Potential gains to insiders are not restricted to trading gains. It is also possible for insiders to profit from not trading.[2] Although Manne and others have mentioned insider nontrading (and the potential profits involved), the practice is largely unknown to outsiders. It can best be described with a few hypothetical case studies.

First, consider the case of Ms. B., a highly placed corporate executive at ABD, Inc. Ms. B. has substantial holdings of ABD stock and, before a mid-morning meeting, she had planned to sell some of her holdings to take profits on a recent rise to $40 a share. At the meeting, she learns of a friendly takeover bid from KNW, Inc. at $60. Ms. B., acting on information not yet in the public domain, holds on to her stock after the meeting. Later, she sells out for $60, reaping a hefty profit from her earlier nontrade. Now, if she had purchased more shares in ABD prior to the public disclosure of the takeover she would have violated existing codes. Although she did not violate any codes, by not going through with a planned sale she clearly used inside information for personal gain. Had she sold at $40, the purchasers would have reaped the gain from the rise to $60.

Next, there is the case of Lloyd R., a stockbroker who has recently lost several clients to a discount brokerage house. Lloyd somehow manages to acquire advance information on the planned takeover of ABD. He also has discovered (more inside information) that his biggest client is about to desert him for a discount broker. He phones the client who has large holdings of ABD, and tells her not to sell. The client holds, makes a huge gain, and, seeing the benefits of a full-service broker, decides not to take her business to the discount broker. Both Lloyd and his client have gained by not trading based on inside information.

The point is that nontrading based on inside information is as much an abuse of inside information as is insider trading. The essential identity of the two practices can be seen in our final case study. Mr. Q., an investment banker, has been hearing rumors that KNW is planning to merge with CYR, Inc. He is planning to purchase a large block of CYR stock on the basis of the rumor and his own judgment that the merger makes economic sense. Before making the purchase, he phones a source at KNW who tells him that ABD and not CYR is the target. He purchases ABD instead and makes substantial gains. Although, the purchase of ABD on inside information is illegal, the nonpurchase of CYR is perfectly legal. Yet, the same inside information is involved in both decisions. Indeed, it is *the same decision.* The decision to purchase ABD is simultaneously a decision not to

[2]The rest of this paragraph and the next two paragraphs are taken from Kelly (1986).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

purchase CYR. Both the trade and the nontrade are "unethical," but only the trade is illegal. The case of Mr. Q. neatly illustrates the illogic of singling out insider trading for legal action while allowing insider nontrading to take place with impunity.

Tens of thousands of executives in thousands of publicly held companies have access to internal information every day. Given the arguments above it seems probable that gains from high visibility events represent only the tip of the iceberg of insider trading gains. Since all insiders are required to report all trades in their firms' shares to the SEC, there is ample data to test the hypothesis that insiders trading in such shares make abnormal returns. Empirical evidence indicates that they do (Seyhun 1986). However, supporters of insider trading regulations have produced no empirical evidence—at least, of which we are aware—to demonstrate that the few high visibility cases that are feasible to prosecute in fact represent the kind of activities that generate the major part of the abnormal returns to insiders. Indeed, based on the arguments above, it seems more probable that they represent the minor part. The remainder of the paper is devoted to the implications of the SEC's practice (as a matter of feasibility) of prosecuting only highly selective cases of insider trading gains.

Problems of Regulation

The SEC currently regulates insider trading under sections 10(b) and 16(b) of the Securities Exchange Act, as well as Rule 14e–3 and Rule 10b–5, adopted by the Commission. Rule 14e–3 regulates trading by insiders when a tender offer is involved; Rule 10b–5 is more general and is the one usually invoked in cases of insider trading. Although it is a violation of Rule 10b–5 to trade on the basis of any material nonpublic information, in practice enforcement is limited to the use of bombshell information. In particular, takeovers have become the principal area of investigation and enforcement. The SEC has not attempted to prevent profiting from the possession of ordinary inside information. Insiders are also free to profit from nontrading. The costs of regulating trading on the basis of ordinary information and nontrading are apparently sufficiently large relative to the benefits to prevent such regulation. Yet, the unregulated gains from the use of inside information probably account for most insider gains. The regulation of insider trading must therefore not be regarded as an attempt to eliminate all or even most of the gains made by investors with material nonpublic information. Rather, regulation aims to reduce or perhaps eliminate one particular type of insider

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

trading. Indeed, the recent activities of the SEC have been devoted to preventing the illegal acquisition and use of inside information by outside speculators.

The issue involved in the regulation of insider trading, then, is not whether to allow insiders to profit from their information; most insider income from equities is legal. The issue is whether to outlaw gains from particular types of inside information, especially advance knowledge of takeover bids. The desirability of current SEC regulations must therefore be judged on the desirability of partial regulation.

To those who believe that insider trading is efficient, there is of course no justification for the regulations unless they view the practice as unfair. It may nevertheless also be true that those who believe that insider trading is unfair or inefficient cannot justify the existing regulations. The absence of justification stems from the partial application of the rule prohibiting insider trading. Partial application of the prohibition may lead to behavior aimed at avoiding illegality while continuing to profit from inside information. One possibility is that those with potential access to inside information on certain stocks will adjust their portfolios so as to be in position to gain. The distortions caused by portfolio adjustments motivated solely by a desire to avoid prosecution for insider trading may cause substantial economic inefficiencies.

Possibly the most important inefficiency of current regulations is due to the distortion of managerial incentives. Suppose that KNW, Inc. has merger discussions already under way with both ABD and CYR. Now, suppose that a merger with ABD makes more economic sense. The manager of KNW (or perhaps the investment banker setting up the deal) owns no ABD stock but has substantial holdings in CYR. Insider trading is not permitted in takeover bids, so the manager cannot buy ABD. He may therefore recommend merging with CYR, because no restrictions are placed on gains from nontrading. The resulting merger generates more benefits to the manager (or investment banker), despite its inferiority to a merger with ABD. The stockholders in KNW and CYR suffer because of the suboptimal merger.[3]

Consider another aspect of the problem. According to Annette Poulsen and Gregg Jarrell (1986), the increasing value of the target firm's stock price allows shareholders to gain from tender offers. This is true regardless of whether the tender offer is hostile or friendly.

[3]Although the behavior described in this paragraph will most assuredly not occur in every case, because of company loyalty and the harm done to a manager's career by poor decisions, current regulations increase the likelihood of such behavior.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

But if the tender offer is successfully fought off, shareholders of the target firm ultimately receive no net gain. Of course, if the tender offer fails, management in the target firm keeps its job. David Kass (1986) argues that an important determinant of whether a tender offer is accepted is the dollar amount of stock held by management of the target firm. The larger this amount the more the gain to management from accepting the offer. If insider trading were legal, management of the target firm could purchase stock in the company and profit sufficiently to cover the loss of salary and position due to the takeover. Under current laws, insider knowledge only benefits management if large blocks of stock are already held. Shareholders (unless management buys them out at a premium) lose if management, influenced by lack of stock ownership, successfully opposes takeovers to preserve its own position. Indeed, one could argue that the increasing interest of the SEC in restricting insider trading is leading to new and widely criticized innovations for managers to keep out takeovers, such as golden parachutes and poison pills.[4] Again, there is a distortion of economic activity. The asymmetric legal treatment of insider nontrading and insider trading biases successful tender offers toward firms where management already holds (and with insider knowledge has substantial incentives not to prematurely sell) a large portfolio of its own company's stock.

The current *de facto* partial illegality of insider trading may therefore at best only mitigate the gains to insiders. Indeed, it may simply redirect how these gains are obtained. Managers and investment bankers have an incentive to arrange takeovers based on their own portfolios instead of attempting to maximize profits for shareholders. And managers have incentives to generate the sort of inside information that will increase the value of their existing portfolios. These distortions of managerial behavior may substantially reduce economic efficiency without necessarily reducing the gains to insiders.

Conclusion

Insiders will profit from material nonpublic information; the prevention of these profits is beyond the power and the will of the SEC. The current campaign against insider trading by arbitrageurs is typical of the SEC policy of emphasizing particular highly visible activities. Most gains from insider information continue to be legal or at least overlooked. Current policy merely introduces additional distortions into the market.

[4]Golden parachutes may, however, facilitate takeovers by reducing the incentive of management to oppose a change in the ownership and control of the firm.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

We believe that a rethinking of SEC policy rules is in order. Although cases of fraud or violation of contracts should not be ignored by the SEC (or some other enforcement agency), insider trading in and of itself might well be left alone. The prohibition of insider trading could be left to the discretion of individual firms. Current regulations do not increase the fairness of investment markets; they serve only to introduce new distortions while diverting attention from other important "offenses."

References

Carlton, Dennis W., and Fischel, Daniel R. "The Regulation of Insider Trading." *Stanford Law Review* 35 (May 1983): 857–95.

Dooley, Michael P. "Enforcement of Insider Trading Restrictions." *Virginia Law Review* 66 (February 1980): 1–83.

Easterbrook, Frank H. "Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information." *Supreme Court Review* (1981): 309–65.

Easterbrook, Frank H., and Fischel, Daniel R. "Mandatory Disclosure and the Protection of Investors." *Virginia Law Review* 70 (May 1984): 669–715.

Kass, David I. "Antitakeover Measures—Obstructions to the Market for Corporate Control? Comment on Poulsen and Jarrell." *Contemporary Policy Issues* 4 (July 1986): 46–49.

Kelly, William A., Jr. "The Plague of Insider Nontrading." *Wall Street Journal*, 12 December 1986.

Manne, Henry G. *Insider Trading and the Stock Market*. New York: The Free Press, 1966.

Manne, Henry G. "Insider Trading and the Law Professors." *Vanderbilt Law Review* 23 (December 1970): 547–630.

Manne, Henry G. "Insider Trading and Property Rights in New Information." *Cato Journal* 4 (Winter 1985): 933–43.

Poulsen, Annette B., and Jarrell, Gregg A. "Motivation for Hostile Tender Offers and the Market for Political Exchange." *Contemporary Policy Issues* 4 (July 1986): 30–45.

Rider, Barry A., and Ffrench, Leigh. *The Regulation of Insider Trading*. St. Dobbs Ferry, N.Y.: Oceana, 1979.

Scott, Kenneth E. "Insider Trading: Rule 10b–5, Disclosure and Corporate Privacy." *Journal of Legal Studies* 9 (December 1980): 801–18.

Seyhun, H. N. "Insider's Profits, Costs of Trading, and Market Efficiency." *Journal of Financial Economics* 16 (June 1986): 189–212.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Tort Reform and the Market-Share Rule

Clifton Perry

Introduction

In a negligence suit the plaintiff must demonstrate that the defendant has acted, that the act is a breach of a duty the defendant owes the plaintiff, and that the plaintiff has suffered an injury by virtue of the transgression. The so-called prima facie case for negligence may be extremely difficult to establish where there are multiple tortfeasors (i.e., multiple defendants) and insufficient evidence to causally connect any particular tortfeasor's breach of duty to the plaintiff's injury. This difficulty is much like the one of apportioning liability when the plaintiff's injury might have had a source independent of the defendant's remiss behavior. In both cases the plaintiff has been injured as a result of a breach of duty owed, but he is unable to prove that the injury is the result of any particular tortfeasor's transgression. These untoward circumstances have helped spur "reform" in tort law: the courts have been forced to apply traditional theories of liability in novel ways and to invent novel theories of liability to ensure compensation. One such theory, the so-called market-share liability theory, allows the injured plaintiff to recover from all possible tortfeasors in proportion to each tortfeasor's degree of fault. What is troubling, however, is not that multiple tortfeasors may be held liable to the degree that is commensurate with their causal responsibility for the plaintiff's injury but rather that the court determines the degree of fault in such cases according to the market share held by each defendant.

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.
The author is Associate Professor of Philosophy at Auburn University.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The market-share rule has been used in some product liability suits,[1] and it has been suggested that it should enjoy extended use in medical malpractice suits.[2] If the market-share theory should encounter troubles, then not only the suggested extension but its initial use might be questioned.[3] In the course of this paper the market-share rule will be examined and possible problems noted.

The "Natural Cause" and "Unknown Defendant" Problems

In one product liability case the issue that concerned the California Supreme Court was the cancer-causing properties of diethylstilbestrol (DES) for the female children of women who ingested the drug. DES, a synthetic compound similar in certain respects to estrogen, was discovered in the late 1930s by British scientists. The drug was initially marketed by U.S. pharmaceutical manufacturers in 1941 with approval of the Food and Drug Administration (FDA) for treating menopausal symptoms, senile and gonorrheal vaginitis, excessive menstrual bleeding, and to suppress lactation.[4] In 1942 it was noted in professional medical journals that DES might be effective in preventing miscarriages.[5] By 1947, DES was marketed as a miscarriage prophylactic under trade names and generically; by the 1960s, DES was being sold by more than 200 companies.[6] Although most manufacturers warned against DES use for women with cancer, they failed to warn about the possible risks of cancer appearing either in those women who took DES or their children. (It is doubtful that manufacturers knew whether DES could cross the placental barrier.)

In 1971 it was noted that a significant increase in clear cell adenocarcinoma among younger women (referred to as DES daughters) had appeared, but not among women of advanced age, as might be

[1]See, for example, Sindell v. Abbott Laboratories, 26 Cal. 3d 588, 163 Cal. Rpt 132, 607 P.2d 924 (1980), *cert. denied*, 449 U.S. 912 (1980); Ferrigno v. Eli Lilly & Co., 175 N.J. Super, 551, 420 A.2d 1305 (1980); Martin v. Abbott Laboratories, 102 Wash. 2d 581, 689 P.2d 368 (1984); and McCormack v. Abbott Laboratories, 617 F. Supp. 1521 (D. Mass. 1985).

[2]See Bushwood (1981).

[3]Many jurisdictions have rejected the market-share rule. See Morton v. Abbott Laboratories, 538 F. Supp. 593 (M.D. Fla. 1982); Payton v. Abbott Laboratories, 512 F. Supp. 1031 (D. Mass. 1981); and Ryan v. Eli Lilly & Co., 514 F. Supp. 1004 (S.C. 1981). Moreover, *Ferrigno* was overruled by Namm v. Charles E. Frost & Co., 178 N.J. Super. 19, 427 A.2d 1121 (1981).

[4]This was noted in the *Morton* decision.

[5]See Karnaky (1942).

[6]As discussed in *Morton*.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

expected (Turner 1981, p. 309). By the end of 1971, the FDA required that manufacturers notify health care providers that DES was counterindicated for prevention of miscarriage. This required proscription came too late to prevent injuries—injuries that proved actionable. Thus far there have been more than 1,000 DES negligence suits; the number of potential plaintiffs may exceed 500,000 and may even reach 6 million.[7]

The problem for each plaintiff in such a tort suit is to demonstrate, by a preponderance of evidence, that the defendant is duty bound to the plaintiff and that the plaintiff has suffered a harm by virtue of the defendant's breach of duty. In most DES suits, proof of the causal efficacy of a particular defendant's breach is difficult to establish for two reasons, only one of which is considered by the courts to be significant. The first and less serious difficulty for the plaintiff in such a case is to show that her cancer was the causal result of taking DES. While there is a significant increase in the number of such cancers in the daughters of women who took DES, the cancer also occurs within the general female population. Statistical information may provide some grounds for an inference as to the causal responsibility of DES for adenocarcinoma. But if the cancer also occurs within the general population, then taking DES would not be the only cause of such cancers and perhaps not the cause in this particular instance. Indeed, a woman who has cancer may have it quite independently of taking DES. This would be true even if the incidence of such cancer is 10 times greater for those who took DES than those who did not. For the purpose of this paper, this problem shall be referred to as the "natural cause problem."

The second and more serious difficulty occurs for those DES takers who purchased their drugs under generic names and where the chain of evidence leading to a specific manufacturer was lost. In one case it was observed that "three and a half years of discovery have revealed nothing that would indicate which, if any, of the defendants is the culpable party."[8] Under such conditions it is not questioned that some one defendant's breach of duty caused the harm to the plaintiff. Rather, it is the identity of the responsible party that is at issue. It is possible that any one of 200 companies is responsible. Consequently, the problem shall be referred to as the "unknown defendant problem."

Each problem is concerned with liability being attributed on the basis of the defendant's breach without a causal nexus being dem-

[7]See, for example, the comments in the *Wall Street Journal* (23 December 1975, p. 1), *New York Times* (17 May 1977, p. 18), and *Boston Sunday Globe* (12 October 1980, p. 5).

[8]As noted in the *Ryan* decision.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

onstrated between the breach and the plaintiff's harm. Since the causal relation between some one defendant's breach and the plaintiff's injury is known, it might be supposed that the impetus to address the plaintiff's claim is rather strong. This appears to be evidenced, however, not by the fervor with which such cases are adjudicated but rather the extent to which courts must go to ensure plaintiff compensation.

Rules for Adjudicating Tort Liability

The best-case scenario with each problem is that only the parties in breach and those causally responsible for the plaintiff's injury are held liable, while all those not in breach or not causally responsible are exonerated. A less than best-case scenario is the finding in favor of the plaintiff when the defendant is actually not in breach or not causally responsible (a false positive mistake) or the finding against the plaintiff when the defendant is in breach and causally responsible (a false negative mistake.)[9]

While avoiding both false positive and false negative mistakes is recommended and indeed ideal, avoiding one mistake seems more obligatory than avoiding the other. Although a good rule for adjudicating tort liability would not permit the plaintiff's claims to be unjustly dismissed, it would seem essential that an acceptable rule would not in and of itself permit a defendant to be unjustly penalized. This would seem correct notwithstanding the fact that, unlike criminal cases, finding a defendant liable in a tort suit is not to find the defendant guilty of a punishable offense. Rather, the purpose of such suits is to restore the plaintiff to his original state. (Otherwise, we should not permit third-party payment on behalf of the defendant.)[10]

It might reasonably be argued, therefore, that in their respective domains, criminal law and civil law are alike in construing false positive mistakes as more of an anathema than false negative mistakes. This does not mean that false positive mistakes are not more vehemently disdained in criminal than in civil law. This may, in fact, be suggested by the use of the more stringent standard of proof in criminal law. The burden of proof used in criminal cases, namely, that defendant guilt must be established beyond a reasonable doubt, would surely render unlikely the commission of false positive mistakes. It is, after all, suspect that the statistical evidence used in the DES cases would place the defendant's responsibility beyond a

[9]For an excellent presentation of this problem, see Kaye (1982).
[10]This is argued persuasively by Thomson (1984).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

reasonable doubt, and insofar as the defendant's causal responsibility would not be established under such a standard of proof, the plaintiff would most likely lose.

However, the amount of evidence necessary for the plaintiff to win his suit under the preponderance of evidence standard is that the defendant merely be shown "more likely to have caused the harm than not." This greatly increases the likelihood that the plaintiff will not be forced to suffer his injury without compensation, which would be the likely outcome from applying the beyond a reasonable doubt standard. Of course, the preponderance of evidence standard will also be subject to more false positive mistakes. It is not only logically but also empirically possible that a nonresponsible defendant be shown to be "more likely than not" responsible for the plaintiff's harm. Nonetheless, it would not follow from this that civil law does not view false positive mistakes with more disdain than it views false negative ones. That is, the goals may be identical between criminal and civil law even though false positive mistakes are more protected against in criminal than in civil law.

The goal, therefore, is to present evidence that satisfies the accepted burden of proof, a burden designed to ensure that only the negligent or guilty individuals are held liable. Since the courts are perforced to decide liability in cases like the DES case noted above, they must do so on the basis of available evidence while also endeavoring to avoid false positive mistakes. If the available evidence empirically establishes, in accordance with the preponderance of evidence standard, that the tortfeasor is more likely responsible than not, then it may be thought not an obvious travesty of justice to hold the tortfeasor liable.

It may, however, seem unfair to affix full liability to a given tortfeasor where the plaintiff's harm may have been caused independently of defendant breach or where many defendants are in breach and there exists insufficient evidence to connect any given breach with the plaintiff's harm. Thus, in an attempt to mitigate the injustice of affixing full liability in cases troubled by either or both difficulties, alternative theories of apportioning liability have been employed. Although it is logically consistent to distribute full liability on the basis of satisfying the preponderance of evidence standard in cases of multiple defendants (the standard of evidence after all determines what constitutes adequate evidence, not what liability rule will be employed on the basis of adequate evidence), it is not clear that a rule for distributing full liability in such cases is either fair or the best way to avoid false positive mistakes.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

One means of assuaging the severity of such mistakes is to employ a rule of liability that would distribute liability only to the extent that the evidence would warrant.[11] The so-called comparative liability rule would appear to preserve judicial disdain toward false positive mistakes in the face of circumstances that appear to cause such mistakes. The comparative liability rule differs from the several liability rule—which permits the plaintiff to collect the full award from any one of the multiple tortfeasors (leaving each tortfeasor to seek indemnity from the others)—and from the joint liability rule, which holds each defendant responsible for an equal share of the award.[12] According to the comparative liability rule, tortfeasors are each held liable according to their respective degree of fault for the plaintiff's harm.

In general the comparative liability rule does not obviate the requirement of showing a causal relation between defendant's breach and the plaintiff's harm. For example, most jurisdictions employ the notion of comparative negligence rather than the notion of contributory negligence. Both notions entail that the plaintiff in a negligence suit has suffered an injury as a result of the defendant's breach but *not only* by virtue of the breach. In both cases, the plaintiff's injury is partly the result of the plaintiff's own negligence. Some jurisdictions, however, employ the idea of contributory negligence, in which the plaintiff is barred recovery upon a favorable finding of plaintiff negligence. In most jurisdictions the notion of comparative negligence allows the plaintiff to recover but only to the extent that the defendant's breach can be shown responsible for the plaintiff's harm. Comparative negligence then employs comparative liability to allow the negligent plaintiff to recover. Nevertheless, in such cases the plaintiff must present evidence as to the actual degree of defendant responsibility for the harm—that is, evidence as to the percent of the plaintiff's harm that resulted from the defendant's breach.

The comparative liability rule might, with respect to the natural cause problem, hold the defendant liable for a share of the plaintiff's award commensurate with the likelihood of suffering the injury by

[11]The comparative liability rule is accepted in the majority of U.S. jurisdictions.

[12]Both of these rules of liability were employed in Summers v. Tice, 33 Cal. 2d 80, 199 P.2d1 (1948). In *Summers* a plaintiff was injured when two hunters, in breach of a duty of care, fired in his direction and injured him. Since only one defendant caused the harm and it could not be determined which one fired the shot that injured the plaintiff, both defendants were held jointly and severally liable (that is, liability apportioned to each individual for an equal share and liability apportioned to any one of several defendants, perhaps allowing for contribution from the other defendants). As both were in breach, the court reasoned that it would be unfair to deny the plaintiff a recovery simply because, through no fault of his own, he could not isolate the causally responsible defendant. The burden of presentation then shifted to each tortfeasor to extricate himself from responsibility.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

virtue of the defendant's breach (for example, in the DES case, ten times the adenocarcinoma cancer suffered in the general female population). Thus, the tortfeasor would be liable for that percent of the award which reflected the increased likelihood of injury associated with the tortfeasor's product or behavior. With respect to the unknown defendant problem, the comparative liability rule might hold each defendant responsible for that share of the plaintiff's award reflected in the proportionate fault each bears for the injury.

But how does one apportion liability according to the comparative liability rule in those cases where there is known negligence that results in plaintiff injury, but where the known malfeasance cannot be attributed to any one of the multiple defendants and each defendant is *equally likely* to have caused the injury but none is separately more likely than not? What shall be done in cases where the known malfeasance cannot be attributed to any one defendant and where all of the defendants, although likely, are not equally likely and none is more likely than not? (There are, of course, other permutations: for example, the DES case where the plaintiff's injury is likely, but is not necessarily, caused by any one of the multiple defendants, each of whom is likely, but not equally likely, and none is more likely than not.)

The California court noted that the comparative liability rule may still be utilized to distribute liability but only insofar as dictated by the statistical evidence at hand. Each tortfeasor may be held liable for the portion of the plaintiff's award that reflected the likelihood that the defendant's breach caused the plaintiff's injury, that is, according to the defendant's market share of the offending product. With the so-called market-share liability rule, the defendants if found negligent, would be liable for that percentage of the plaintiff's award determined by their respective share of the market.

Problems with the Market-Share Rule

Unfortunately, there are two significant problems with this approach. First, the comparative market-share liability rule, although more in accordance with the total number of cases taken as a *whole*, is less in accordance with the total number of cases taken as the *summation* of the individual cases. In other words, the individual tortfeasor's breach is either responsible for the plaintiff's injury or it is not. If the tortfeasor is responsible and the market-share rule is applied, then there obtains a partial false negative mistake, which is the difference between the percentage of the total award for which the responsible tortfeasor is held responsible and the total award. If the tortfeasor's

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

breach is responsible for the plaintiff's injury and the market-share rule is applied, then there obtains a partial false positive mistake, which is the difference between the amount for which the innocent tortfeasor is held liable and zero. Whereas the several liability rule and the joint liability rule in a joint enterprise might result in a correct judgment in the *individual case*, the comparative market-share liability rule can, at best, only approximate such a judgment. This is notwithstanding the fact that the market-share liability rule is likely to have a better correspondence with available statistical evidence. Thus, probable responsibility cannot justify a finding of complete or partial liability; statistical information may surely evoke suspicion, but it cannot warrant an inference about individual responsibility or lack of such.

Second, the comparative market-share rule confuses the likelihood that the breach caused the plaintiff's injury with the likelihood of a causal relation between the breach and the plaintiff's injury. What is generally required in a negligence case is evidence of an empirical nature that connects a particular defendant to the contested malfeasance, misfeasance, or nonfeasance. Evidence that satisfies the beyond a reasonable doubt standard is evidence that substantially eliminates every other reasonable hypothesis that might be proffered to explain the facts. The preponderance of evidence standard, on the other hand, requires merely a relative weighing of the evidence. Such a standard would establish defendant liability on the basis of compiled empirical evidence that more than not connects the defendant's breach to the plaintiff's harm to an extent somewhat approximating, but obviously not reaching that required by the beyond a reasonable doubt standard. Thus, the preponderance of evidence standard is satisfied when evidence is produced demonstrating that the defendant's breach is "more *likely* than not" the cause of the plaintiff's harm.

The notion of "likely" employed in the market-share rule, however, merely requires evidence of the fact that the defendant's breach might have caused the plaintiff's harm. The rule requires evidence only to the extent that the defendant's breach is shown to have had the *opportunity* to harm the plaintiff, while the preponderance of evidence standard requires more or less good (but not conclusive) evidence establishing that the defendant's breach actually did cause the plaintiff's injury. On the other hand, the market-share rule of liability requires the establishment of only the opportunity to cause the plaintiff's injury; the more extensive the opportunity, the more extensive the liability. But the opportunity to wrongfully injure is merely necessary, not sufficient, for the injury. The advantageous

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

opportunity to act fails to establish the *likely* commission of the act, and producing evidence for the former is not tantamount to producing evidence for the latter. It does not, after all, require a prodigious imagination to fabricate a scenario wherein the empirical evidence incriminates the candidate with the *least* opportunity to commit the deed in question. To satisfy the preponderance of evidence standard, a preponderance of empirical evidence would need to be produced beyond that necessary to demonstrate the chance to act because, as was noted above, there is more to showing that a defendant is likely to have committed an act than showing merely his extent of opportunity.

In effect then, the use of the market-share liability rule acknowledges that each tortfeasor is in breach and that the plaintiff's injury is the result of one such breach. Consequently, other than the one tortfeasor whose breach actually caused the plaintiff's harm, every other tortfeasor is held liable merely for the breach plus the opportunity to cause the harm. A mere breach without a causal relation to the damage, however, is not actionable in negligence. That is, because the prima facie case for negligence entails a causal nexus between the breach of duty and the plaintiff's injury, the prima facie case has not been satisfied with the market-share rule. If the causality requirement of the prima facie case is to be in some sense preserved under the market-share rule, the opportunity to harm must be equated with the degree of causal responsibility. But neither the alternative of jettisoning the causal element nor the alternative of equating causal efficacy with opportunity would seem a welcomed one.

It might be thought that the market-share rule may be extricated from the above problems once it is realized that the rule merely shifts the burden to the defendants. After the plaintiff has demonstrated that he has suffered injury through the breach of duty by one of multiple tortfeasors, the burden shifts to each defendant to prove, by a preponderance of evidence, that he is not the responsible agent.

Unfortunately, such a consideration may very well be an instance of *ignoratio elenchi*. First, in certain jurisdictions the principle of *res ipsa loquitur* shifts the burden of presentation to the defendant, but that in itself would not entail that the defendant would be held liable *merely* on the grounds that he had the opportunity to harm the plaintiff.[13] In other words, doctrines that shift the burden of presentation to the defendant require evidence of likely commission, not evidence of opportunity to commit. The principle of *res ipsa loquitur* is designed to address the issue of the unknown defendant on the basis of an

[13]In the majority of American jurisdictions *res ipsa loquitur* merely presents a permissible inference. A minority of courts has uniformly given *res ipsa loquitur* greater effect, namely, a rebuttable presumption. See Prosser (1971, pp. 228–38).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

agent's control over the instrumentality that causes the plaintiff's injury after breach of duty has been established. The market-share rule is likewise designed to address the problem of the unknown defendant after a breach of duty has been established. The difference is that although both *res ipsa loquitur* and the market-share rule shift the burden to the defendant(s), only *res ipsa loquitur* does so on the basis of evidence connecting the particular agent with the plaintiff's harm. The market-share rule shifts the burden merely on the basis of the opportunity to cause the plaintiff's injury. Consequently, since both rules shift the burden to the defendant and the principle of *res ipsa loquitur* does not encounter the causal problems noted with the market-share rule, such causal problems cannot be the result of shifting the burden of presentation.

Second, the shift in the burden of presentation would appear to be just as easily accommodated by the several liability rule. If each defendant suffers the burden of defending against the charge of negligence, then except in those cases where the defendant could demonstrate partial responsibility only, each would be liable for the total award.

Conclusion

If the above problems are not mere fabrications, the plausible extension of the market-share rule might excite some concern. Besides litigation for other toxic substances, such as asbestos, Agent Orange, and toxic waste, it has been suggested that where a patient is harmed through the negligence of one or several health care professionals, all might be held liable according to the share each enjoys of the patient's economic expenditure.[14] That is, each health care provider would be held liable for that portion of the plaintiff's award which corresponds to the percent of the practitioner's dollar value related to the dollar value for all the services provided by the sum of the defendants. This, it has been argued, is sensible since the fee each health care provider charges is alleged to correspond to the amount of responsibility each provider assumes for the patient's welfare.[15]

[14]Consider, for example, *In re "Agent Orange" Product Liability Litigation*, 635 F.2d 987 (2d Cir. 1980), *cert. denied*, 454 U.S. 1128 (1981). However, it is not known what rule was implemented in the out-of-court Agent Orange settlement. See Earley (1984a, 1984b) and Blumenthal (1984a, 1984b). It has been noted by the Rand Corporation that for each dollar spent by asbestos companies in litigation, 37 cents went to victims. The remainder was spent on attorneys and overhead. See Brown (1985).

[15]See Bushwood (1981). Of course, the problem of finding for the harmed plaintiff even when the source of the negligence is unknown has, in some jurisdictions, been adjudicated under *res ipsa loquitur*. See Ybarra v. Spangard, 25 Cal.2d 486, 154 P.2d 687 (1944).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

There are, of course, other problems with the market-share rule that are of some concern—for example, the problem of determining the appropriate "market" for use and the relationship between use of the market-share rule and tort reform.[16] There are also many proposed alternatives to the present methods of legally negotiating product liability claims.[17] Apart from these considerations, if the above has not proved apocryphal, it seems that what is troubling about the market-share rule is the problem of causality. If such a problem is to be eliminated, the market-share rule ought to be restricted to apportioning liability *after* it has been established by a preponderance of evidence that a given tortfeasor is only partially responsible for the plaintiff's injury.[18] If such a reform is not employed, civil adjudication may err excessively in the direction of false positive mistakes.

References

Blumenthal, Ralph. "7 Companies Plan Fund for Those Who Link Harm to Herbicide." *New York Times*, 8 May 1984a, sec. B.

Blumenthal, Ralph. "Agent Orange; How Fund Will Work." *New York Times*, 9 May 1984b, sec. B.

Brown, John P. "Alternatives to the Present System of Litigation for Personal Injury." In *The Effects of Litigation on Health Care Costs*, pp. 69–81. Edited by M. A. Baily and W. I. Cikins. Washington, D.C.: Brookings Institution, 1985.

Bushwood, David B. "Market Share Liability and the Health Care Professional." *Law, Medicine and Health Care* 9 (December 1981): 30–31.

Earley, Pete. "Viet Vets' Herbicide Suit Settled." *Washington Post*, 8 May 1984a, sec. A.

Earley, Pete. "Dow Plans to Seek to Recoup Herbicide Settlement Funds." *Washington Post*, 9 May 1984b, sec. A.

Fischer, David. "Products Liability—An Analysis of Market Share Liability." *Vanderbilt Law Review* 34 (1981): 1623–50.

Karnaky, Karl J. "Use of Stilbestrol for the Treatment of Threatened and Habitual Abortion and Premature Labor." *Southern Journal of Medicine* 35 (1942): 838–47.

Kaye, David. "The Limits of the Preponderance of Evidence Standard: Justifiably Naked Statistical Evidence and Multiple Causation." *American Bar Foundation Research Journal* 2 (Spring 1982): 487–516.

[16]See Fischer (1981).

[17]The Uniform Product Liability Bill (S. 44), introduced by Senator Kasten in March 1984, would have altered what theories of tort liability are appropriate for the various claims against producers. The New Zealand system, castigated for removing all incentives for product safety in the absence of strict governmental regulation, abandoned tort litigation for all accidents in favor of a comprehensive, no-fault system.

[18]If the tortfeasor is shown to be fully responsible, the market-share rule would not apply.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Prosser, William. *The Law of Torts*, 4th ed. St. Paul, Minn.: West Publishing Co., 1971. 228–38.
Thomson, Judith Jarvis. "Remarks on Causation and Liability." *Philosophy and Public Affairs* 13 (Spring 1984): 101–33.
Turner, Melissa. "Bearing the Burden of DES Exposure." *Oregon Law Review* 60 (1981): 309–24.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Judicial Immunity vs. Due Process: When Should a Judge Be Subject to Suit?

Robert Craig Waters

Introduction

In the American judicial system, few more serious threats to individual liberty can be imagined than a corrupt judge. Clothed with the power of the state and authorized to pass judgment on the most basic aspects of everyday life, a judge can deprive citizens of liberty and property in complete disregard of the Constitution. The injuries inflicted may be severe and enduring. Yet the recent expansion of a judge-made exception to the landmark Civil Rights Act of 1871, chief vehicle for redress of civil rights violations, has rendered state judges immune from suit even for the most bizarre, corrupt, or abusive of judicial acts.[1] In the last decade this "doctrine of judicial immunity" has led to a disturbing series of legal precedents that effectively deny citizens any redress for injuries, embarrassment, and unjust imprisonment caused by errant judges. Consider the following examples.

- In 1978, the Supreme Court in *Stump v. Sparkman*[2] held that the doctrine forbade a suit against an Indiana judge who had authorized the sterilization of a slightly retarded 15-year-old girl under the guise of an appendectomy. The judge had approved the operation without a hearing when the mother alleged that the girl was promiscuous. After her marriage two years later, the girl discovered she was sterile.

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.

The author is Judicial Clerk to Justice Rosemary Barkett of the Florida Supreme Court.

[1]The doctrine of judicial immunity from federal civil rights suits dates only from the 1967 Supreme Court decision in Pierson v. Ray, 386 U.S. 547 (1967), which found a Mississippi justice of the peace immune from a civil rights suit when he tried to enforce illegal segregation laws. Until this time, several courts had concluded that Congress never intended to immunize state-court judges from federal civil rights suits. See, for example, McShane v. Moldovan, 172 F.2d 1016 (6th Cir. 1949).

[2]435 U.S. 349 (1978).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

- In 1980, the Seventh Circuit Court of Appeals in *Lopez v. Vanderwater*[3] held a judge partially immune from suit for personally arresting a tenant who was in arrears on rent owed the judge's business associates. At the police station, the judge had arraigned the tenant, waived the right to trial by jury, and sentenced him to 240 days in prison. Six days of this sentence were served before another judge intervened. The Seventh Circuit found the judge immune for arraigning, convicting, and sentencing the tenant but not for conducting the arrest and "prosecution."
- In 1985, the Eleventh Circuit Court of Appeals held in *Dykes v. Hosemann*[4] that the immunity doctrine required dismissal of a suit against a Florida judge who had awarded custody of a child to its father, himself the son of a fellow judge. This "emergency" order had been entered without notice to the mother or a proper hearing when the father took the boy to Florida from their Pennsylvania home after a series of marital disputes.
- In 1985, the Tenth Circuit Court of Appeals in *Martinez v. Winner*[5] held a federal judge immune who, during a trial, had conducted a secret meeting with prosecutors without notifying the defendant or his attorneys. Expressing concern that the jury would be "intimidated" into a not-guilty verdict, the judge agreed to declare a mistrial after the defense had presented its case so the government could prosecute anew with full knowledge of the defense's strategies.

In just 20 years, these precedents and others like them have established near-total judicial immunity as a settled feature of American law. Under the current doctrine, any act performed in a "judicial capacity" is shielded from suit.[6] Thus, the simple expedient of disguising a corrupt act as a routine judicial function guarantees immunity from suit. In no other area of American life are public officials granted such license to engage in abuse of power and intentional disregard of the Constitution and laws they are sworn to defend. Those who are harmed, no matter how extensive and irreparable the injury, are deprived of any method of obtaining compensation. They are confined to disciplinary actions that only rarely result in the judge's removal from office despite the troubling frequency of judicial abuses (see Alschuler 1972).

[3]620 F.2d 1229 (7th Cir. 1980).
[4]776 F.2d 942 (11th Cir. 1985) (rehearing en banc).
[5]771 F.2d 424 (10th Cir. 1985).
[6]See Stump v. Sparkman 435 U.S. 349, 360 (1978).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

As will be shown below, this sweeping new immunity doctrine is at odds both with American legal history and the Constitution. Congress never intended to exempt state judges from suit when it passed the 1871 Civil Rights Act. Moreover, the judiciary is wrong when it asserts that immunity was a settled doctrine, incorporated into the 1871 Act by implication. To the contrary, the doctrine in its present form did not exist in the United States or England when the civil rights legislation was passed in 1871. Moreover, the immunity doctrine is inconsistent with the due process clause of the Fourteenth Amendment. Even if the doctrine had existed in common law, constitutional supremacy dictates that it must bow before the American idea of procedural justice embodied in the guarantee of due process.

The American Concept of Due Process

The Fourteenth Amendment was enacted soon after the Civil War as a reaction to abuses by Southern officials.[7] Its effect was no less than a revolution in American law. For the first time, the states were obligated to observe a minimum standard of justice imposed by the federal courts. Previously, the Bill of Rights had bound only the federal government. Absent a direct affront to federal powers, the pre–Civil War Supreme Court had refused to interfere in the judicial proceedings of any state, even to preserve due process rights created by the Fifth Amendment.[8] If state courts ignored personal liberties, no redress was possible in the federal courts.

When adopted in 1868, the Fourteenth Amendment expressly bound state officials to observe the minimum standards of justice being developed by the federal courts. In time, the Supreme Court held that the amendment's due process clause obligated state courts to obey virtually every provision of the Bill of Rights. Under this evolving concept, due process embodied at least the specific liberties guaranteed by the Constitution.[9] By the centennial of the Fourteenth Amendment in 1968, state courts were required at a minimum to provide adequate notice and a right to be heard through counsel before deciding the rights or liabilities of any person.

In effect, the Fourteenth Amendment integrated the federal and state courts into a single judicial system adhering to a uniform minimum standard. This new system immediately generated problems

[7]See Pierson v. Ray, 386 U.S. 547, 559 (1967) (Douglas, J., dissenting) (1871 Act passed in response to Southern lawlessness).

[8]See, for example, Barron v. The Mayor & City of Baltimore, 7 Pet. 243, 8 L. Ed. 672 (1833), holding that the Fifth Amendment does not apply to state action.

[9]See Duncan v. Louisiana, 391 U.S. 145 (1968), holding that the Fourteenth Amendment "incorporates" specific provisions of the Bill of Rights.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

without precedent in American law. When state courts asserted jurisdiction over out-of-state residents or their property, the federal courts frequently found themselves called upon to decide the validity of such acts. Ignoring the underlying due process concerns at first, the Supreme Court tried to resolve the problem with a theory of jurisdiction based largely on pre–Civil War notions of state sovereignty. Under this conception, the right of a court to exercise its authority over specific persons—its "personal jurisdiction"—extended only as far as the state borders and were of no force beyond them.[10]

As the 20th century progressed, the Supreme Court soon found the state-sovereignty theory inadequate. New forms of transportation and communication blurred the significance of state boundaries. An increasingly integrated national economy soon made it possible for activities in one state to produce profound disruption in another. Moreover, the Supreme Court was unable to resolve a perplexing inconsistency in its theory: if state sovereignty was the only issue, then an out-of-state resident could never confer jurisdiction on a state court merely by giving consent. In theory, sovereignty could be waived only by the sovereign that possessed it.[11] Yet the Supreme Court, bowing to a rule of practicality, consistently had held that a litigant could confer personal jurisdiction on any state court by consent, even if the consent was implied by out-of-court activities.[12]

Finally in 1982, the Supreme Court swept aside the sovereignty theory and held that the jurisdiction of state courts was circumscribed solely by the due process clause.[13] A state court's authority over anyone, including out-of-state residents, was restricted not by political boundaries but by the conception of fair play and procedural justice embodied in the Constitution.[14] Thus, personal jurisdiction was an aspect of due process. State judicial power was directly limited by individual liberties guaranteed by the Bill of Rights. As an important consequence, the right to challenge improper activities of a state court took on a new and as yet unexplored constitutional dimension.

Due Process and Judicial Immunity

The Supreme Court's holding that the due process clause limited state courts' power was surprising only in that it had taken so long.

[10]See, for example, Pennoyer v. Neff, 95 U.S. 714, 720 (1878).

[11]See Insurance Corp. of Ireland v. Compagnie des Bauxites de Guinea, 456 U.S. 694, 702 n. 10 (1982).

[12]See, for example, McDonald v. Mabee, 243 U.S. 90 (1917).

[13]456 U.S. at 702 n. 10 and accompanying text.

[14]Id. at 703.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Many legal commentators had argued for years that jurisdiction of state courts over specific people was a due process problem, not a question of the competing sovereignties of two or more states.[15] Indeed, the older sovereignty theory, a relic of pre-Civil War jurisprudence, virtually had ignored an ancient line of English case law extending back to Article 39 of Magna Charta, ancient predecessor of the due process clause. These cases, dealing with the question of judicial immunity, long ago had established virtually the same due process limitation on judicial power announced in 1982 by the Supreme Court.

As early as 1613, English courts had recognized that Article 39 restricted the power of judges. Early English decisions had found that judges lost immunity from suit for acts clearly beyond their jurisdiction.[16] Only in a single area did the English common law grant a broad form of immunity to judges. Recognizing a need to protect judges from the displeasure of the Crown and its ministers, the Star Chamber in *Floyd v. Barker*[17] had held that a judge could not be prosecuted in another court for an alleged criminal conspiracy in the way he had handled a murder trial. In refusing to try the case, the judges of Star Chamber held simply that if the king wished to discipline a judge, the king must do so himself without resort to a criminal prosecution.[18]

Despite this narrow focus, *Floyd* frequently is cited as the foundation of the American judicial immunity doctrine.[19] The federal courts' lavish reliance on this Star Chamber decision is puzzling. While the immunity doctrine focuses exclusively on civil liability for judicial acts, *Floyd* is concerned not with liability but with the proper method of disciplining alleged misconduct of judges. Indeed, *Floyd*'s central concern is not judicial immunity at all, but judicial independence from the executive branch of government. The American constitutional system largely has resolved the problem that preoccupied the judges who wrote *Floyd*.

[15]See, for example, Lewis (1983) for a discussion of the historical development of the Supreme Court's theory of state-court jurisdiction.

[16]See The Case of the Marshalsea, 77 Eng. Rep. 1027 (K.B. 1613) (no immunity when Court of the Marshalsea asserted jurisdiction over persons outside the king's household, its sole jurisdiction). The *Marshalsea* court specifically traced jurisdictional limits to Article 39 of Magna Charta (Id. at 1035).

[17]77 Eng. Rep. 1305 (Star Chamber 1608).

[18]Id. at 1307.

[19]See, for example, Pulliam v. Allen, 104 S. Ct. 1970, 1975 (1984). The Supreme Court first relied on *Floyd* as a precedent for judicial immunity in Bradley v. Fisher, 80 U.S. (13 Wall.) 335, 351 (1872).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The current American immunity doctrine not only was a serious departure from its common law antecedents but also broke with early American case law. As early as 1806, the Supreme Court in *Wise v. Withers*[20] had recognized a right to sue a judge for exercising authority beyond the jurisdiction authorized by statute. In 1869, one year after passage of the Fourteenth Amendment and long before due process had assumed its modern contours, the Supreme Court made its first effort to define the limits imposed on state judges. The Court held that state judges possessing general powers were not liable "unless perhaps when the acts . . . are done maliciously or corruptly."[21] Then in 1872, one year after the civil rights laws were passed, the Supreme Court overruled its earlier dictum and announced that judges would not be liable even for malicious or corrupt acts.[22]

This 1872 expansion of the immunity doctrine was an abrupt departure even from the common law recognized by a majority of the states in the Civil War era. By the time civil rights legislation passed in 1871, only 13 states had granted their judges a broad form of judicial immunity, while six states had found judges unquestionably liable for malicious acts in excess of jurisdiction.[23] Eighteen other states had not addressed the issue at all,[24] although many recognized English common law as binding precedent. Thus, from 1869 to 1872 the Supreme Court extended a sweeping form of immunity to state-court judges that a majority of the states themselves would not have recognized under their own law.

Immunity and Civil Rights Legislation

Nor was this emerging doctrine recognized by the post–Civil War Congress. Ample evidence shows that Congress intended to make all state officials, including judges, subject to its new civil rights legislation, even in those states recognizing a broad form of immunity. The congressman who introduced the Civil Rights Act of 1871 announced that his bill was modeled after the Civil Rights Act of 1866,[25] which had created criminal penalties for anyone engaging in state-sponsored efforts to violate the civil rights of citizens. Indeed, the 1871 Act was written to provide a civil remedy—the right to sue

[20]7 U.S. (3 Cranch) 331 (1806).

[21]Randall v. Brigham, 74 U.S. (13 Wall.) 523, 535-36 (1869).

[22]Bradley v. Fisher, 80 U.S. (13 Wall.) 335, 351 (1872).

[23]"Liability of Judicial Officers" (1969, pp. 326-27 and nn. 29-30).

[24]Id. at 327 nn. 31, 32 and accompanying text.

[25]*Congressional Globe*, 42d Cong., lst sess. 68 app. (1871) (remarks of Rep. Shellabarger).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

for damages—in every instance in which the 1866 Act offered a criminal penalty.[26]

One fact is clear about the 1866 Act: it unquestionably had abolished judicial immunity from criminal prosecution, in effect overruling the precedent in *Floyd*. Partly because of this feature, President Andrew Johnson had vetoed the bill,[27] and Congress promptly had overridden the veto amid indignant cries about the tyranny of local Southern officials. During the vote to override, one representative had sharply responded to the President's concern:

> I answer it is better to invade the judicial power of the States than permit it to invade, strike down, and destroy the civil rights of citizens. A judicial power perverted to such uses should be speedily invaded. . . . And if an officer shall intentionally deprive a citizen of a right, knowing him to be entitled to it, then he is guilty of a willful wrong which deserves punishment.[28]

Others declaimed that immunity for any state official must be abolished because immunity "is the very doctrine out of which the rebellion was hatched."[29]

The debate on the Civil Rights Act of 1871 itself was no less critical of the wrongs perpetrated by Southern officials. In biting rhetoric, one representative characterized local judges in the former Confederate states as despots prone to violate the rights of Republicans without regard for law or justice.[30] Many others vehemently agreed.[31] On three occasions, congressmen plainly stated that state-court judges would be unable to claim immunity under the 1871 Act.[32] Yet another representative expressly noted that the legislation would correct a specific injustice: the use of harassing litigation and unjust prosecutions in Southern courts meant to silence political opponents or chase them from the state.[33]

Despite this evidence from the congressional debates, a majority of the Supreme Court in *Pierson v. Ray*,[34] 96 years after the 1871 Act

[26]Id.

[27]*Congressional Globe*, 39th Cong., lst sess. 1680 (1866) (presidential veto message to Congress).

[28]Id. at 1837 (remarks of Rep. Lawrence).

[29]Id. at 1758 (remarks of Rep. Trumbull).

[30]*Congressional Globe*,, 42d Cong., lst sess. 394 (1871) (remarks of Rep. Platt).

[31]For example: Id. at 394 (remarks of Rep. Rainey), 429 (remarks of Rep. Beatty), and 153 app. (remarks of Rep. Garfield).

[32]Id. at 217 app. (remarks of Sen. Thurman), 385 (remarks of Rep. Lewis), and 365–66 (remarks of Rep. Arthur).

[33]Id. at 185 app. (remarks of Rep. Platt).

[34]386 U.S. 547 (1967).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

was passed, decided that Congress never had intended to subject state-court judges to suit. Arguing that judicial immunity was "solidly established at common law," the Court presumed that Congress would have incorporated specific language into the statute had it wished to abolish the doctrine.[35] This perplexing conclusion utterly ignored the remedial purposes of the 1871 Act[36] and the long-standing rule that a remedial statute will be construed liberally to achieve its purpose (see Llewellyn 1950).

Not only did the majority offer a complete distortion of congressional intent[37] but it also decided that the phrase "[e]very person . . . shall be liable" meant every person except judges.[38] Yet Congress clearly had intended to remedy a serious injustice being inflicted on innocent people by corrupt local officials, including judges. In effect, the Supreme Court created a new rule of statutory construction that judicial immunity is to be favored over congressional intent, and only express language in a statute will limit the doctrine.

Finally, in 1978 in *Stump* the Supreme Court wielded its ever-expanding immunity doctrine to prevent suit against a state-court judge who had authorized sterilization of a mildly retarded 15-year-old girl after her mother had "petitioned" for the sterilization "to prevent unfortunate circumstances."[39] The judge had authorized the procedure without a hearing, notice to the girl, or appointment of a guardian *ad litem* to represent the girl's interests.[40] Recognizing that the judge had violated the most elementary principles of due process, the Supreme Court majority nonetheless found him immune from a suit later filed by the girl and her new husband. Even "grave procedural errors" do not deprive a judge of immunity, ruled the Court, because immunity attaches to any act performed in a judicial capacity.[41] The Court noted that the judge had signed the sterilization petition as a judge; and it dismissed objections that failure to observe formalities rendered the act nonjudicial.

Instead, the Court concluded that an act is "judicial" if it possesses two traits: first, the act is one normally performed by a judge, and, second, the parties intended to deal with the judge in an official

[35]Id. at 554–55.

[36]See id. at 560 (Douglas, J., dissenting).

[37]Id. at 558–67 (Douglas, J., dissenting).

[38]The 1871 Act provides that "every person" who violates the civil rights of a citizen by acting under state authority is liable for a federal civil action for money damages. 42 U.S.C. § 1983 (1985).

[39]435 U.S. 349, 351 n. 1.

[40]Id. at 360.

[41]Id.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

capacity.[42] The Court, however, interpreted the first of its requirements very broadly. The majority noted that the judge in *Stump* possessed "general jurisdiction," the ability to decide any matter not specifically withheld from him. Since no statute expressly denied him the power to hear sterilization petitions, he was immune even though such a petition was unprecedented in the history of the state and not authorized by any statute.[43] In this way, the Supreme Court excused a gross departure from due process that would have subjected virtually any other state official to suit. The effect was plain: under the doctrine of judicial immunity, a victim can be forced to bear the full burden of a serious, irreparable injury inflicted by a state-court judge in blatant violation of the Constitution.

The Policy Underlying Judicial Immunity

The *Stump* test for immunity affords no impediment to a corrupt judge. At best, it cloaks a judge with immunity if he merely indicates his official status while performing any act not expressly prohibited by law.[44] At worst, it offers a road map for corruption with total impunity. Those subject to a corrupt judge's power may find little comfort in the Supreme Court's pronouncements that judicial immunity in effect is a necessary evil, the price to be paid for a "fearless" judiciary.[45] With power to abridge liberty and seize property, state-court judges are the masters of everyday life in America. They are capable of causing enormous and irremediable harm to someone who, like the 15-year-old girl in *Stump*, simply is not given a chance to protect his or her own interests before the judge irreparably abridges them.

Yet the Supreme Court insists in the strongest of language that a sweeping immunity shield is necessary for an impartial judiciary. Permitting dissatisfied litigants to sue judges, argues the Court, "would contribute not to principled and fearless decision-making but to

[42]Id. at 360.

[43]Id. at 367–68 (Stewart, Marshall and Powell, JJ., dissenting).

[44]One federal appeals court has required the weighing of four separate factors similar to the *Stump* test: (1) whether the act was a normal judicial function; (2) whether the events transpired in the judge's chambers; (3) whether the controversy was then pending before the judge; and (4) whether the confrontation arose directly and immediately out of a visit to the judge in his official capacity. McAlester v. Brown, 469 F.2d 1280, 1282 (5th Cir. 1972). See also Dykes v. Hosemann, 776 F.2d 942, 945–46 (11th Cir. 1985) (rehearing en banc) (quoting *McAlester* with approval); Harper v. Merckle, 638 F.2d 848, 858 (5th Cir.), *cert. denied,* 454 U.S. 816 (1981) (quoting *McAlester* with approval).

[45]See Ferri v. Ackerman, 444 U.S. 193 (1979).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

intimidation."[46] Under this viewpoint, immunity is not for the benefit of the malicious and corrupt but for the benefit of the public, whose best interests are protected by an independent judiciary.[47] If errors are committed, the proper remedy is appeal.[48]

Few would question the worthiness of such abstract principles as impartiality and fearlessness, even if the Supreme Court's assessment of judicial courage is surprisingly pessimistic. However, high-flying abstractions often serve only to hide the underlying issue, which in this case is the injury a corrupt judge can inflict on innocent people. Congress and the courts must seriously question any device that affords greater protection to the unscrupulous than to the principled. In this instance, the risk of such a disturbing result is very grave. By resort to the current immunity doctrine, an unscrupulous judge could escape liability even for acts of revenge, gross favoritism, improper seizure of property, unjust incarceration, or serious injuries inflicted "in a judicial capacity." Most disturbing are those instances in which a judge ensures that an appeal cannot remedy the wrong inflicted. In *Stump*, for instance, the judge's actions allowed no appeal prior to court-ordered surgery that would prevent a woman from ever having a family. If appeal indeed is the proper method of challenge, the judiciary cannot justify granting immunity to judges who have prevented an appeal from occurring.

The history of judicial immunity makes the doctrine even more suspect, since Congress clearly believed it was imposing liability on local judges under the 1871 Act.[49] By judicial fiat, the doctrine was conjured out of a few old English cases such as *Floyd* that were not themselves concerned with judicial immunity from suit, but with judicial independence from the Crown. The Supreme Court, citing dicta in these cases, invented a completely new immunity doctrine far more expansive than the Civil War-era precedents would warrant.

Most troubling of all are the strong due process interests that necessarily are involved in any judicial immunity controversy. By wielding its expansive doctrine, the Supreme Court in effect has declared that every organ of state government except local courts must observe the dictates of the Fourteenth Amendment. The irony is unmistakable: those who are the guardians of the Constitution are themselves privileged to violate it with corrupt impunity. Any dam-

[46]Pierson v. Ray, 386 U.S. 547, 554 (1967).

[47]Id.

[48]See Pulliam v. Allen, 104 S. Ct. 1970, 1975-76 (1984).

[49]Pierson v. Ray, 386 U.S. 547, 562 (Douglas, J., dissenting) ("every member of Congress who spoke on the issue assumed . . . that judges would be liable").

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

age inflicted on innocent citizens must be borne by the injured, not by the state or its insurers. Due process, one of the most hallowed and ancient of rights, apparently has no place in the law when a citizen attempts to seek recompense from a judge who has wrongfully caused an injury.

Nor has the Supreme Court made any effort to reconcile its new theory of state-court jurisdiction with judicial immunity. If a state court's power over persons is defined and limited by the due process clause, the current immunity doctrine assumes a deeply suspicious character. The judiciary in effect is wielding a judge-made rule of law to limit a constitutional right, turning the idea of constitutional supremacy on its head. When a local judge chooses to act corruptly, the logical result of any sweeping immunity doctrine is the destruction of due process rights. Instead of fearless impartiality, the doctrine thus protects only malice and arbitrary administration of the laws.

The Due Process Clause as a Limit on Immunity

If judicial immunity truly is to serve as a bulwark of justice, some more clearly defined limit must be placed on it. Logically this limit must arise from the due process clause itself. Clothing a judge with immunity simply because he has performed a "judicial act" overlooks the real-world probability that even judicial acts can be utterly inconsistent with due process. Important personal rights, such as the right to have a family in *Stump,* can be destroyed by the mere nod of a judge's head. Judges should not be privileged to violate the rights of citizens unfortunate enough to find themselves in a biased, corrupt, or irresponsible court. When unjust injuries are inflicted by improper judicial acts, the state or its insurers should be forced to bear the cost of the wrongful act, not the individual. Indeed, the history of the 1871 Act reveals that Congress intended to provide just such a remedy.

Instead of the abstract and ambiguous factors used in *Stump* to determine the existence of immunity, the courts should use a simpler inquiry founded on the fundamental principles embodied in the due process clause. To preserve the integrity of the judicial process, the courts always should presume that a trial court properly exercised its jurisdiction. But they should permit a plaintiff to overcome this presumption by showing that the judge acted with actual malice, consisting of a knowing or reckless disregard of due process. Specifically, if the court is to enjoy immunity, it must afford three things—notice, a chance to be heard, and a method of appeal. Then, and only then, would an irrebuttable presumption of immunity exist requiring dismissal of any subsequent suit against the judge.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Of these three requirements, the opportunity to appeal should be the most crucial based on the policy that appeal, not a suit for damages, is the preferred method of challenging a judge's improper actions. Deprivation of an opportunity to appeal effectively renders this policy meaningless and makes some other remedy necessary for proper redress. Moreover, the right to appeal usually can correct due process violations. Even errors in notice and opportunity to be heard should not of themselves subject a judge to suit as long as the opportunity to appeal is present. In effect, the appeal itself will afford a new opportunity for a proper hearing with proper notice.

Nor should routine *ex parte* orders create any liability for the judiciary. In emergency hearings for the seizure of property, the court could preserve the irrebuttable presumption of immunity by affording as soon as possible the required notice, a hearing, and the right to appeal.[50] In summary incarcerations, as for contempt of court, the judge could preserve his immunity by affording the defendant an immediate opportunity for further review, such as in a habeas corpus hearing. Mere failure of the plaintiff to exercise these rights should never subject the judge to suit. Nor should a judge be liable for errors of judgment, even those plainly forbidden by law or precedent, as long as his acts did not deliberately preclude the possibility of appeal *before* constitutionally protected rights were completely foreclosed.

The test proposed above also addresses the question of subject-matter jurisdiction—the statutory authority of judges to hear specific kinds of disputes. Although the Supreme Court suggested in *Stump* that a clear lack of subject-matter jurisdiction will subject a judge to liability, it was plainly troubled by the possibility that a judge might be subjected to suit for an honest and harmless mistake.[51] A test based on the ability to appeal necessarily will shield good-faith errors. As long as the judge does not take actions that prevent appeal, he will be protected by an irrebuttable presumption of immunity.

Conclusion

American courts have agonized over the due process problems created in recent years by the doctrine of judicial immunity.[52] A

[50]The courts have long recognized a right of creditors to obtain prejudgment "attachment" of property in which they have an enforceable interest if the debtor is likely to flee from the court's jurisdiction. The U.S. Supreme Court has imposed rigorous due process limits on the use of such remedies, generally requiring notice and an opportunity to be heard immediately after the disputed property has been seized. See, for example, Sniadach v. Family Finance Corp., 395 U.S. 337 (1969).

[51]Stump v. Sparkman, 435 U.S. 349, 356 (1978).

[52]One of the clearest examples was in *Dykes v. Hosemann*, where the Eleventh Circuit

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

variety of ill-conceived approaches to the issue have resulted in "tests" that grant immunity to state-court judges in such sweeping terms as to amount to no test at all. The Supreme Court, troubled by threats to judicial independence, has developed its own test that invests judges with immunity for any act performed in an official capacity where the act itself is not expressly prohibited by existing law. Under this approach, corrupt and malicious local judges may easily shield even the most serious abuses behind a wall of immunity, leaving the victim unable to seek compensation from the state and its insurers.

Yet a state court's jurisdiction is limited by due process guarantees of notice and a chance for an impartial hearing. Ignoring this fact, the Supreme Court has misconceived the problem by basing judicial immunity purely on statutory concerns and distorted readings of common law history. Like the jurisdiction of local courts, immunity itself—a judge-made doctrine—must be limited by due process, which is of constitutional dimension. The supremacy clause unquestionably nullifies even the most ancient of common law principles and even the most popular of state statutes to the extent they are inconsistent with due process.

The best solution is to give judicial immunity a firm root in due process guarantees. To achieve this result, the simplest approach is to create an irrebuttable presumption of immunity where the state-court judge's acts did not deliberately terminate a citizen's rights without notice, hearing, and opportunity to appeal. Of these three requirements, the chance to appeal is the most important because it provides a means of curing defects in any other due process violation. A judge thus remains unquestionably immune as long as he does not take actions that intentionally and plainly prevent further review. The duty imposed on a state-court judge, then, is only to recognize that his own decisions may sometimes be in error and to ensure that orders affecting important constitutional rights can be reviewed in another court.

References

Alschuler, Albert W. "Courtroom Misconduct of Prosecutors and Trial Judges." *Texas Law Review* 50 (April 1972): 629–735.

---

at first stripped a Florida judge of judicial immunity for actions clearly violating the due process clause (743 F.2d 1488, 1496 [11th Cir. 1984]). Then, in a rehearing en banc, the full panel completely reversed the prior decision and held that judicial independence was so strong a concern that due process must yield before it (776 F.2d 942, 949 [11th Cir. 1985]). In a sharp dissent, Judge Hatchett criticized the majority for holding everyone liable for due process violations except the very people trained in due process—judges (Id. at 954–55).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Lewis, Harold S., Jr. "The Three Deaths of 'State Sovereignty' and the Curse of Abstraction in the Jurisprudence of Personal Jurisdiction." *Notre Dame Law Review* 58 (April 1983): 699–742.

"Liability of Judicial Officers under Section 1983." Unsigned student note. *Yale Law Journal* 79 (December 1969): 322–37.

Llewellyn, Karl N. "Remarks on the Theory of Appellate Decision and the Rules or Canons about How Statutes Are to Be Construed." *Vanderbilt Law Review* 3 (April 1950): 395–406.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

WHY IS EDUCATION PUBLICLY PROVIDED? A CRITICAL SURVEY

John R. Lott, Jr.

Introduction

Schooling is publicly provided by every nation. Such a unique position is shared only by a very limited range of goods—national defense, courts, police, and roads. It is not immediately obvious, however, why education deserves such a special role. Nevertheless, in the United States educational outlays comprise more than 40 percent of the combined state and local budget expenditures. In countries such as Sweden, Israel, and the Netherlands, public non-capital expenditures on education account for more than 7 percent of the nation's gross domestic product.

What is especially perplexing about public provision of education is its cost. Per pupil expenditures are much higher in public schools than in private ones, but cognitive development has been found to be lower in public schools. Inefficiencies of public provision are not unique to education (Borcherding et al. 1982; Savas 1982), but the problem is to explain why all countries have adopted public provision even though it is less effective at teaching skills than private education.

A wide range of justifications and/or explanations of public provision of education can be found. This paper will argue that most of these hypotheses fail to explain why there is public provision instead of some other form of intervention. They also fail to explain why their reasoning is not equally applicable to other goods that are not publicly provided. Many of these explanations also share two additional problems: a paucity of empirical tests directly related to explaining public provision, and the lack of a general theory equally applicable to all countries.

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.

The author is Visiting Assistant Professor of Economics at Rice University. This paper was accepted while he was a National Fellow at the Hoover Institution. He wishes to thank Harold Demsetz, Gertrud Fremling, Finis Welch, and E. G. West for helpful discussions.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

In the following sections, this paper reviews the costs of public provision and the conditions under which it arose in the United States and England, discusses the eight most frequently advanced explanations for public provision, and argues for a different hypothesis based on public choice theory.

The Cost of Public Provision

Per pupil costs are substantially higher in public schools than in private schools. Table 1 shows the case for the United States, where it costs about twice as much to educate public school pupils. About three-quarters of the private schools are church-affiliated, and services contributed by religious staff are valued at less than market value, thus lowering the cost figures for private schools. Yet, even relatively liberal assumptions of the implied subsidies do not significantly alter the case. If we assume that 11 percent of current expenses go to religious staff salaries and that religious teachers are paid one-half the rate of lay staff (Bredeweg 1982, pp. 38–56), public expenses are still at least 1.83 times greater than private costs. Savas (1982, p. 102) found similar public/private differentials in schooling for both the severely and nonseverely handicapped. Given the magnitude of public expenditures, the financial gains from contracting out for such services would be tremendous.

The evidence suggests that the organization of resources in public schools is also wanting. Hanushek (1972, 1986) presented empirical evidence that current hiring practices and salary scales in public schools do not encourage those skills in teachers that produce higher student achievement. Salary scales reward teachers based on expe-

TABLE 1

AVERAGE CURRENT EXPENDITURES PER PUPIL IN PUBLIC AND PRIVATE SCHOOLS

School Year	Expenditures per Pupil ($)			Ratio: Public/ Private	Adjusted Private ($)	Ratio: Public/ Adjusted Private
	Average	Public	Private			
1976–77	1,353	1,544	760	2.03	844	1.83
1977–78	1,512	1,736	819	2.12	909	1.91

SOURCES: *NCES Bulletin*, U.S. Department of Health, Education, and Welfare, 23 October 1979; *United States Catholic Elementary and Secondary Schools 1981–1982: A statistical report on schools, enrollment, staffing, and finances*, 1982.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

rience and level of graduate education, both of which were found unrelated to student achievement test scores. Instead, a teacher's intelligence, as measured by scores on verbal ability tests, was highly related to such gains. Staaf's (1977b, pp. 152–65) brief survey of the literature confirms these findings.[1]

Alchian (1965) explained such results by pointing out some general characteristics of public organizations and then, in a later paper, applied his reasoning specifically to education (1968).[2] Public organizations, according to Alchian, do not directly concentrate the costs and benefits on decision makers. Hence, they have an incentive to shirk. The market process, on the other hand, forces firms to compete for customers, and firms inept at providing services will lose their customers to other firms. The organization of public schools protects educators from such competition because payments are not made directly by the students receiving the services, nor do public employees bear the consequences of poor service.

Recent work on student cognitive achievement provides further support for this hypothesis. By contrasting private and public educational systems with data on 59,000 high school students, Coleman et al. (1982) found that, after controlling for family background variables that predict achievement, children attending private schools learn at a faster rate. Using standardized achievement test scores in two developing countries, Columbia and Tanzania, Cox and Jimenez (1987) provided evidence that private schooling is superior to public schooling.[3]

In sum, the evidence suggests that public provision is costly not only in terms of current expenditures but also in terms of forgone investment in human capital. Nor does the list of such costs end here. If we accept that some of the public benefits derived from education are related to the level of investment in human capital, then less efficient public provision may have other costs as well.

[1]See Lott (1984) for a further review of this literature. West (1970) also provides a useful survey of the history of economic thought on this subject.

[2]See Alchian and Kessel (1962) for a similar discussion.

[3]One difficulty with the Coleman et al. findings is that they fail to examine what differences in family characteristics cause certain children to be sent to private schools in the first place. For example, the decision to send a child to a private school may signal the presence of other parental investments in their children, which may be responsible for some portion of the differential rates. But since this last effect cannot explain all of the difference, the study does confirm Alchian's predictions. West (1983) provided a public opinion survey showing that consumers of these services also believe that private schooling is of a higher quality than public schooling. Cox and Jimenez attempted to control for why the child was sent to a private school. See also Lott (1987e).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Introduction of Public Schools and the Level of Schooling

A brief survey of the history of education for the United States and Great Britain indicates that the introduction of public schools has produced only small gains in the general level of education. The 1860 U.S. Census shows that in states of the original 13 colonies, the white literacy rate in those states with public schooling was 99 percent compared with 93 percent in those states without it. This difference of only 6 percentage points may, however, be partly explained by the more rural nature of the states without public schools (Montgomery 1878, p. 6).[4]

In New York, the Free Schools Act abolishing fees for common (public) schools was not passed until 1867, and compulsory schooling was not instituted until 1874 (West 1967, p. 105). However, as early as 1812 a report commissioned by the state found: "In a free government, where political equality is established, and where the road to preferment is open to all, there is a natural stimulus to education; and accordingly *we find it generally resorted to unless some great local impediments* interfere" (quoted in West 1967, p. 103). In 1821 New York counted 352,479 students of all ages attending school out of a population of approximately 380,000 children aged 5 to 16 (p. 105). West (p. 127) concluded that, for New York, if "the term 'universal' is intended to mean, something like, 'most', 'nearly everybody', or 'over 90 percent' then we lack firm evidence to show that education was not already universal prior to the establishment of laws to provide a schooling which was both compulsory and free."

In his examination of the common school movement in New England, Fishlow (1966, pp. 40–67) argued that although the public system expanded both absolutely and in percentage terms, it did not add significantly to the percentage of children being educated. The primary effect of the public system was to shift children from private to public schools. Using data for Massachusetts, Field (1974, p. 22) found that "[Horace] Mann and his reformers were successful in the first one of their instrumental drives: curtailing the growth of private schooling." Field (p. 30) did not rule out the possibility that the entire increase in public attendance was at the expense of private attendance.

[4]Even if one argues that the states that first adopted public provision were the ones with the lowest initial literacy rates (and this does not seem to be the case), this does not affect my argument that in those states averaging a literacy rate of 93 percent, the potential gains from public provision were small.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

State involvement in the public provision of education in England is usually dated from the Foster Act of 1870. Its objective was not universal free public schooling, but rather to "fill the gaps" in the private system; publicly provided schools received about one-third of their funds through fees from parents (West 1970, pp. xviii–xix). In fact, compulsory schooling was not established until 1880, and fees were not abolished until 1918. Yet ample evidence exists of widespread private schooling long before this act.

West discovered that in England "most people were already literate in 1870" and that "most parents bought education by modest fee-paying" (pp. 136, 131). Webb (1963) estimated that in the late 1830s between two-thirds and three-quarters of the working classes were literate. If anything, such figures may be underestimates, since those who performed the surveys usually were reformers anxious to establish the inadequacy of a purely private system (West 1970, p. 128).[5] Some have argued that if the government had any net effect on education during the first third of the 19th century, it was negative because of the imposition of taxes on schooling materials, the closing down of public reading rooms, and in certain cases the withdrawal of licenses from inns and coffee houses receiving particular newspapers (p. 127).

Table 2 provides convincing proof of West's claim that by 1858 most British children received some schooling. Out of a total population of 19.5 million in 1858, 2.5 million children were attending private schools. If there were 5.3 million children between the ages of 3 and 15, and if we accept the education commission's 1861 estimate that the average duration at school was 5.7 years, no apparent deficiency would have existed in the education of children (p. 142). West concluded that "what remains clearly to be shown [by the apologists of the 1870 Foster Act] is that the increase of school places in the government sector was not completely offset by the damage done to the growth of the private sector" (p. 156).

Using data from the *Michigan Income Dynamics Study* (1966–74), Lazear (1983) provided additional contemporary evidence that private incentives alone will yield investments in education relatively close to optimal levels. To the extent that parents cannot perfectly internalize the returns to investments in their child's education (that

[5]West (1970, pp. 129–30) presented evidence that in 1838, 87 percent of the workhouse children of Norfolk and Suffolk could read to some extent and 53 percent could write. In 1840, 79 percent of the miners of Northumberland and Durham could read, and about 92 percent of the adult population of Hull (population of 14,526) could read in 1839. West (pp. 132–35) provided additional evidence, such as the number of persons signing the marriage register, that confirms his earlier findings.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

TABLE 2

GROWTH IN PRIVATE SCHOOLING, 1818–58

Year	Population	Population of 3 to 15 Year Olds	Number of Students in Day Schools	Ratio of Students to Number of 3 to 15 Year Olds
1818	11,642,683	3,504,448[a]	674,883	.193
1833	14,386,415	4,330,311[a]	1,276,947	.295
1851	17,927,609	5,295,780[b]	2,144,378	.405
1858	19,523,103	5,311,534	2,535,462	.477

[a]Derived in a similar manner as that for 1851, but I used the earliest estimates obtainable (1841) as a proxy for the percentage of population in this age group.
[b]Derived by assuming uniform distribution of population in the 0 to 4 and 15 to 19 age groups in 1851.
SOURCES: Mitchell (1980, p. 52); West (1970, p. 149).

is, intergenerational transfers cannot be enforced), their private return will lie below the social return on these investments. Lazear estimates an upper bound on this underinvestment of only 0.282 years for the mean individual.

A strong case can be made that, at least in some countries, public provision of schooling had a trivial (if any) effect on the proportion of children receiving education. In fact, as will be shown later, public provision was not necessarily the historical product of a belief that children would otherwise go uneducated, but rather of a belief that they were receiving the wrong type of education. It therefore seems difficult to argue that a universally applicable explanation for public provision can rest on the desire to end illiteracy.

Public Goods and Public Provision

Alleged inefficiencies resulting from private production of public goods are often assumed to be reduced by public intervention. Such reasoning has provided a positive theory of the state (see Kalt 1981 for a discussion of this literature).

Friedman (1955, pp. 124–25) provided what is perhaps the most influential argument for government support of schooling to secure external benefits. Because buyers of education confer external benefits on those not purchasing education, the result is too little education. By taxing those who receive these benefits and subsidizing those purchasing education, the welfare of both groups can be improved. Friedman's reasoning justifies rules that require minimum levels of education, and government financing may be the least expensive way of enforcing them.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

More recently, however, Friedman (1976, p. 92) has stressed the differences between the existence of average and marginal net positive externalities:

> I have never found any plausible argument for net positive externalities from schooling that would not be satisfied if 90 percent, to take an arbitrary figure, received schooling—the three R's. I have yet to see a plausible argument for any net positive marginal externality from additional schooling. But if this be so, and if private interest alone could lead to at least this much schooling—as I believe it is overwhelmingly plausible that it would—then there is no case from externalities for either compulsory schooling or the governmental financing of schooling.

If we accept Friedman's arbitrary figure of 90 percent, then the historical evidence presented above strongly confirms his belief that private interest alone often was sufficient to assure this level even before the introduction of either free public provision or compulsory schooling.

Two questions remain: Do such benefits exist, and, if so, what would be the best means of obtaining them? The next section reviews what economists and educators believe with regard to these questions.

Democracy as a Public Good

The relationship between democracy and education has been assumed to take three different, though not mutually exclusive, forms, depending on whether the benefit is believed to be the product of an individual's cognitive skill level. There appears to be a consensus that cognitive skills are positively related to support for democracy.[6] Some even claim that education itself is used to instill democratic values and a common set of views.[7] Thus, the three views can be

[6]The relationship between cognitive skills and support for democracy requires few references. Cohn's (1979, p. 260) extensive survey of the literature on the economics of education concluded: "Education provides a broad understanding of various aspects of the sciences, literature, and arts that help in molding 'well-rounded' people who are more likely to strive for the survival of democracy. Government provision and/or support of education is therefore regarded as a means to perpetuate and strengthen democracy." Others, such as Stapleton (1978, p. 29), found that high school and college graduates are generally more likely to participate in political activities, although he warned this may not be equivalent to increased support of democracy. See also Weisbrod (1962, p. 119) and West (1968, pp. 35–38).

[7]The notion that education creates a common set of views is widely held. Friedman (1962, p. 86) wrote: "A stable and democratic society is impossible . . . without widespread acceptance of some common set of values." Tullock (1983, p. 139) claimed that history "indicate[s] very clearly that Americanization and improving the quality of the votes cast by citizens were major motives [for public education]." Gurwitz (1982, p. 22) wrote, "Education is one mechanism through which the shared norms and common experiences that contributed to social cohesion and stability are inculcated." And John Stuart Mill ([1848] 1973, p. 953) offered his famous statement that "the uncultivated cannot be competent judges of cultivation."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

described as hinging on whether one believes (1) democracy is something innately valued; (2) the intrinsic value of democracy is somehow realized as one becomes more educated; or (3) support of democracy should be taught in schools. A further division can be made in the second view between those who regard education as a means of instilling specific views or as inculcating a willingness to accept disagreement of others.[8] These differing views are well summarized by Davis and North (1971, p. 237), who predict that those groups excluded from the political process will not have the cost of their education socialized.

Several observations conflict with these views. First, the existence of democracy did not necessarily follow public provision of education. In fact that was often not the case as witnessed by two rather pominent examples—the United States and Great Britain. Second, the homogenization-of-cultures argument does not appear to provide a universal explanation of public provision. For example, Sweden (Heidenheimer 1982, pp. 269–99; Huntford 1980), which is regarded as homogeneous by many different measures (religion, race, and language), instituted public schooling relatively early. An interesting implication of this homogenization is that if everyone agrees with each other, it may lower the returns to voting.

The view that parents are unable to judge what are the proper views to be taught in a democracy can be examined on two levels. First, how can individuals choose the representatives who will make this decision if they cannot adequately judge the education themselves (West 1970, p. 211)? Second, why do we allow people to make extremely complicated decisions involving other areas of life (for example, which doctor will operate on a child), but not which educator will teach their child? Ironically, the rationale for the First Amendment assumes the competition of ideas is a good (Coase 1974).

Rowley and Peacock (1975, p. 128) note that tolerance of others is not a difficult problem to solve. Vouchers can produce social mixing simply by attaching restrictions to their use. In any case, the present system, which vouchers would replace, often encourages social isolation by zoning children from highly homogeneous neighborhoods into a single school. Through an examination of American public, Catholic, and private schools, Coleman et al. (1982, pp. 28–71) found that while there are relatively few blacks (though not fewer Hispan-

[8]The third point of view focused on the use of public education to create "social mixing" that would foster tolerance of other views necessary to run a democracy. Levin (1980, p. 251) expressed this view: "What makes the voucher approach unique is that parents will be able to send their children to schools that will reinforce in the most restrictive fashion the family's political, ideological, and religious views."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ics) in private schools, minority groups are much less segregated in private schools than in public schools. Their report also supports the hypothesis that private schools are diverse with respect to family income. When one considers only the broad middle-income category (those families with annual income of $12,000 to $38,000 in 1978), the children in this group are similarly distributed across the three types of schools.

If one accepts the first argument—linking the level of human capital to external benefits from democracy—and if one believes private schooling produces more human capital, it follows that a private system with a subsidy is superior to the present public school system.

A strong argument against the first or third explanation for public provision of education is that using subsidies would be more effective. As will be shown in the next section, however, this does not apply to the indoctrination hypothesis for public education. The explanation that follows will be a variation on the indoctrination theme.

Crime Reduction as a Public Good

Historically, the link between crime and education played an important role in the adoption of public provision of schooling.[9] The literature has proposed two possible relationships between education and crime. The most prominent view among modern economists focuses on an individual's future income stream as the opportunity cost of committing crimes.[10] Others, particularly many classical economists, point out that inculcating certain beliefs (for example, religious views or respect for private property) makes committing a crime

[9]West (1967, p. 108) quoted proponents of a free public system as arguing that under such a system, "it will be found universally true that the *minimum* of crime exists, where the *maximum* of moral education is found." Field (1974, pp. 42–48) found similar evidence in his study of the roots of public education in Massachusetts.

[10]A few references illustrate the relationship between earnings and crime. Singer (1972, p. 291) explains: "By increasing labor productivity, education raises the opportunity cost of crime, the losses that the criminal suffers if he is caught and the income he might have earned as a member of the labor force." Weisbrod (1964, p. 101) notes: "Benefits of education may take the form of reduced social costs of other activities; inadequate education appears to contribute to low income, which is associated with delinquency and crime. Thus, education may provide social benefits by freeing some resources now devoted to law enforcement and allied activities." Finally, Cohn (1979) built on earlier work by Phillips et al. (1972) showing that labor market status is a sufficient factor to explain rising juvenile crime rates. Cohn conjectured that if education increases labor force participation rates, increased education could help reduce the crime rate. Other prominent contemporary economists, including Friedman (1976, p. 92), support these arguments.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

more costly.[11] Presumably, this is mainly achieved through instilling guilt. Despite differing views on the causal relationship between education and crime, one observation is widely accepted: education lowers crime and therefore constitutes a public good.

Two policy implications can be derived from the two views. Accepting the first view that private schooling increases investment in human capital more (and/or at a sufficiently lower cost) than does public schooling implies the superiority of subsidies over public provision. Moreover, Lott (1987e) has found that, even after controlling for other factors, increases in the proportion of children attending public schools are associated with increased juvenile delinquency rates for both U.S. time series data and California cross-sectional data by county.

The second view, that public schools instill certain beliefs, has less clear implications for the relationship between crime and education. As Lott (1987a) has shown, even with subsidies limited to governmentally approved schools, competition between them under a voucher-type system could result in underproduction of the political and moral beliefs sought. However, this hypothesis also predicts that public schooling should be more effective than private schooling in lowering juvenile delinquency, and this is not the case.

Economic Growth

Some economists have justified past government intervention in education by pointing to divergences in the private and social rates of discount (Davis and North 1971, pp. 240–41). They claim the divergence results from "the poor state of development of the private capital markets and the relatively better state of the market for government funds, a situation that was probably characteristic of the

[11]In reviewing the opinions of classical economists, West (1970, p. 112) wrote: "But all the economists were strikingly united on one aspect at least of what can be called negative utilitarianism, that is, in the idea that education could reduce crime and disorder." Many believed the difficulty with private schooling was that it provided "the *wrong* sort of education," and they hoped to "lessen parental control over education" and obtain the "ultimate control of education" (West 1980, p. 5). Even Adam Smith (1776, vol. 2, p. 309) anticipated this later view: "The state however derives no inconsiderable advantage from their instruction. The more they are instructed, the less liable they are to the delusions of enthusiasm and supposition, which among ignorant nations, frequently occasion the most dreadful disorders." Sir William Petty, however, probably was the first to claim the link between education and crime; he argued in 1662 that by controlling religious views, government could reduce crime (High 1984, p. 4). Thus, the view of earlier economists differs from those of their intellectual descendants. Rather than using the pecuniary cost of crime explanation, they focused on indoctrination by the state. See High (1985, pp. 312–14) for a historical account of other economists who have believed that state education reduces crime.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

United States in the early decades of the nineteenth century" (p. 240, see also pp. 105–66). For example, public provision of engineering classes at West Point in 1802 and the subsequent public employment of its graduates by the army were justified by virtue of their readiness to fill positions in private industry in the 1830s. Davis and North then explain the coinciding de-emphasis of engineering at West Point in the 1830s: "Once the potential demand for engineers had become a real demand, engineering education became profitable even at private rates of discount, and it was no longer necessary for the government to continue its subsidy."[12] The key word is "subsidy." As Cohn (1979, p. 262) pointed out, "[Government provision] does not require government control of schools; the same objective could be achieved via some form of subsidy."[13]

Finally, it is not clear that government intervention has achieved the desired results. From his analysis of data for Britain and the Netherlands, Chiswick (1969) concluded that if one also considers nonhuman capital assets, minimum schooling requirements actually lower the wealth of relatively poor people. This is presumably because their return to other activities is higher than that in education.

Public Provision as a Means of Creating Wealth Transfers to Educators

A hypothesis accepted by many economists (see Coase 1974, p. 390; High 1985, pp. 314–15; and Tullock 1983, p. 141) has been offered by West. West's (1967, 1968, 1970) studies of the history of public education in England and the United States have indicated that one primary force moving both countries toward free public

[12]Even if we accept the claim that the cost of government borrowing was less than for private groups during the early 1800s (and it is not evident that it was), the argument does not explain why public schooling was not introduced until the 1870s in many parts of the United States and in England. By itself the argument also explains too much. If the explanation were correct, the government should have subsidized the building of factories as well. Further, it is not clear why the differences in "potential" and "real" demand are important. While it is true that potential demand is associated with greater risk to the individual investor, it is also related to greater risk to the government. The cost to the government is forgone safer investments. See High (1985, pp. 315–36) for a discussion of the original debate over the economic growth arguments of Pigou, Smith and Sidgwick.

[13]After an extensive review of the literature, Cohn (1979, pp. 137–61) found that although the evidence for the United States suggests that more education increases income, some studies have shown only a very weak relationship between education and the growth of the real national product in a number of countries. This could possibly be caused by mandated increases in educational investment leading to less investment in sectors where the marginal product of capital is higher.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

education and compulsory schooling was the desire to transfer wealth to educators. By reducing competition from private schooling, as well as the returns from alternative student activities such as work, the efforts required by teachers to keep students in public schools were diminished. Further, since state payments to schools and educators varied according to the number of students in a school, the incentive to further eliminate such alternatives was strengthened. Elimination of private competition, however, did not always engender hostility from private teachers, because private schools were at times incorporated into the public system through gradually increasing subsidies. An expanding public system should also provide employment for displaced private-school teachers.[14]

Staaf (1977a) reasoned along similar lines, pointing to the relatively recent consolidation of school districts as evidence of changes designed to benefit members of the educational bureaucracy. Eugenia Toma (1983) provided weak empirical evidence to explain why professionals support appointed rather than elected state school boards and state superintendents. She found that educational professionals associated appointed boards with higher salaries, lighter teaching loads (defined as pupils per teacher), and more administrators per pupil.[15] Toma (p. 116) characterized the electoral process as a "monitoring device [that] constrains the ability of bureaucrats to transfer surplus to special interest coalitions or to themselves." But she failed to investigate why politicians in certain states prefer adopting appointed school boards and state superintendents for ensuring higher transfers. The fact that the transfers to educators vary systematically with the type of bureaucracy (or institutional arrangement) implies that such transfers are created purposely for educators.

While West is correct in claiming that public provision creates wealth transfers to educators, such transfers cannot be a sufficient motivation for public provision of education. Governments have been able to create transfers to other occupations without resorting to public provision. Given the costly nature of public education (both

[14]Public educators' desire to eliminate private competition is extensively documented (Field 1974, pp. 17–18, 20; West 1967, pp. 114–15). In New York, West found the agitation for compulsory schooling, which arose after the institution of free public schools, consistent with the hypothesis that teachers seek to maximize their income (1967, p. 124; 1968, p. 55). An examination of the history of English public schooling favors the wealth-transfers-to-educators hypothesis (1968, pp. 53–55). Recently, public school teachers in France demonstrated against President Mitterand's failure to keep his campaign promise to abolish private schooling (Lepage 1983).

[15]Toma's control variables change across regressions; they are often insignificant and sometimes of the wrong sign.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

in terms of per pupil expenditures and forgone investment in human capital), why has some combination of licensing laws and subsidies not been used? If West's finding applied equally to all countries adopting public provision, why do they all choose this method of creating transfers? The answer is that transfers to educators must take this particular form because something else is being produced.

Public Provision as a Means of Creating Wealth Transfers to Capitalists

Recent Marxist literature links the rise of factory production to the introduction and expansion of public schooling in America. These studies argue that the growth in public schooling was the product of an increased demand for a properly socialized work force and citizenry (Field 1974, p. 43; Bowles and Gintis 1976, pp. 174–75). The gains obtained by capitalists range from less crime (Field 1974, pp. 42, 48–49) to a more docile work force (pp. 50–52). Schools are seen as a means of instilling certain values (pp. 40–42), but those who benefit from this indoctrination constitute only a subset of society.

According to Field, when business and the professions are broadly defined to include clergymen, educators, newspaper editors, and lawyers, 85 percent of the members of the Lowell, Massachusetts, school board in the mid-19th century were drawn from business and professional groups and fewer than 5 percent were workers (p. 54). Field also found that school boards attempted to expand education by lengthening school sessions when particularly unruly groups—in the Lowell case, the Irish—were present in the population. School attendance rates, however, show that they were unsuccessful in attracting the Irish to public schools. Thus, despite the school board's efforts, schools were relatively unsuccessful in instilling the "correct" beliefs (pp. 312–18).

Gintis (1971, p. 274) described the function of schooling in America as creating a reward system that supposedly produces students well-suited to the "authoritarian" structure of factory production. His evidence consists of the "arbitrary" nature of grading. The structure of grading is claimed to be only partially explained by a student's cognitive abilities and primarily is viewed as rewarding those students who conform to the behavioral demands of teachers.

Gintis used his findings to explain certain "outstanding anomalies." For example, he explained the numerous studies showing "very low monetary returns to the education of lower class people and blacks in the U.S., even with the level of cognitive development taken into account," as resulting from a "failure of schooling to incul-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

cate the required noncognitive personality traits in the observed groups" (1971, p. 267). Bowles (1972), on the other hand, attempted to explain such differential returns by pointing to the direct effect of family background on earnings. He claims that the measurement error is greater for family background than for other variables. Therefore, not surprisingly, correcting for this error increases the relative importance of family background.

Both Bowles and Gintis ignore the findings of Becker and Chiswick (1966) and Chiswick (1969) that help explain differential returns to schooling. Chiswick (1969) found that minimum schooling legislation results in lower returns to schooling for poor people. Becker and Chiswick suggested that the differential returns to schooling may also result from not controlling for postschool investments. They point out that less well-educated people generally put more time into postschool investments than do better-educated people, and that since this investment takes place upon leaving school, the earnings of the less well-educated people will be particularly low at younger ages.

The primary difficulty with the claim that public education arose to subsidize businessmen is that it cannot explain the prevalence of public education across countries. It is not possible to limit the indoctrination aspect of education to capitalist systems. In fact, Lott (1986) has shown that it is actually the relatively more socialist countries that place a higher value on such indoctrination.

Wealth Transfers to the Middle Class: Director's Law

A public goods discussion of equality helps facilitate a comparison of goals and consequences. Although equality is deemed desirable, many argue that the reality of the transfers produced by public provision of education coincides much more closely with "Director's Law," which states that public expenditures are made primarily for the benefit of the middle class.

The public goods nature of equality in education is widely accepted. Guthrie (1980, p. 91) argued that "one of the primary goals of education is to bring about an equitable redistribution of income."[16] Levin (1980, p. 252) claimed public provision was necessary to ensure

[16]Weisbrod (1962, p. 119) concurred with this opinion: "Equality of opportunity seems to be a frequently expressed social goal. Education plays a prominent role in discussions of this goal, since the financial and other obstacles to education confronted by some people are important barriers to its achievement. If equality of opportunity is a social goal, then education pays social returns over and above the private returns to the recipients of education." Kohn (1969), Bowles (1973), and Bowles and Gintis (1976) also hold similar views.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

equality, because a system of subsidies would not be as effective. Poor parents would send their children to schools that reinforce those values that caused the parents to be poor.

Does public provision really have the intended effect of lessening income disparities? Stigler (1970, pp. 1–2) takes a strong stand against the historical success of public schooling in producing equality.[17] Studies by Hansen and Weisbrod (1969a, 1969b) confirmed Stigler's hypothesis for higher education in California. They found that more affluent students typically attend more affluent schools, and a much larger fraction of the rich than the poor attend state-subsidized schools. Later, Peltzman (1973) found that the effect of subsidized higher education has been to shift students to public universities without greatly affecting total higher education enrollment. He concluded that the effect of such subsidies has been to transfer wealth to middle- and upper-income families who would have sent their children to college anyway.

Grubb (1971) found that supporting elementary and secondary schooling in Boston to be regressive. His findings also supported Stigler's argument that upper-income families receive a larger absolute benefit from education on average than lower-class families. Others have claimed that the quality of a public school is positively correlated with the neighborhood's level of income (West 1968, p. 29; Becker 1972, pp. 254–55).

Some have made the mistake of confusing income equality with equality of wealth. Gurwitz (1980, p. 92) proposed that one way of reducing inequality was to force people to purchase "more education than they would choose, or be able, to purchase in a perfectly free market." Chiswick (1969) suggested that minimum schooling legislation, which increases investments in schooling, lowers investments in assets that have higher returns than schooling. Compulsory schooling would therefore diminish the inequality of wage income but *increase* the inequality of wealth.

Stigler (1970), citing Director's Law, claimed that education redistributes wealth to middle-income families because income provides an easy way to discriminate between coalitions of voters. As with other forms of discrimination, redistribution only succeeds if those who are its beneficiaries are unable to resell the good to those who are being discriminated against. Education, like most services, is nontransferable.

The evidence supporting Director's Law—that publicly provided education redistributes wealth from the poorer to the richer—is con-

[17]See also Becker (1972, p. 254) and Demsetz (1982, p. 91).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

vincing. But it ignores certain institutional considerations and therefore has missed the correct underlying explanation of public provision. For example, Peltzman's explanation that low prices reduce the cost of a college education to those who would have purchased it anyway, appears incompatible with evidence that subsidies are limited to only a restricted number of public colleges. Why would people not be allowed this subsidy at any college in the state? Assuming that increased competition between schools increases quality, the people already receiving the subsidy simply receive an even larger real subsidy under competition. Further, Director's Law does not explain why schools within any given school district are not forced to compete against each other. The assignment of students to schools closest to their residence seems unnecessarily restrictive. If one wanted to separate income groups, school districts could be drawn (as they are in fact often drawn anyway) to take this into account. Limiting competition to those schools within a particular school district would not be identical to a full-fledged voucher system, but it would be an improvement in efficiency and would retain the system's redistributive aspect.[18]

Possibly, this seemingly inefficient arrangement of forbidding competition can be explained by focusing on other outputs being produced, which are valued by politicians. One output could be the inculcation of views politicians value. If politicians have limited resources, but want as many children as possible to attend public schools, they must provide higher-quality schools to wealthier families because they have more elastic demands for public schooling with respect to quality. Creation of wealth transfers from the poor to the rich is only incidental and does not contradict the argument. However, questions of why other methods of indoctrination are not as effective must still be examined.

[18]The Marxist view also fails to explain geographical assignment of students. Bowles (1973, pp. 352–53) argued that "the social relations of schooling are a reflection of the social relations of production," and that the social relations of production are also reflected in the views of upper- and middle-income parents, who teach children to be self-directing and curious, and working-class parents, who want schools to emphasize "conformity to external authority." If this is true, a voucher or competitive public system would accomplish the same ends. To the extent it is not true, a competitive system must weaken the notion that the structure of production instills certain beliefs in parents. If geographical assignment is necessary because working-class parents value their children being taught to be imaginative, then the structure of the production must not be very effective in influencing the views of parents. The Marxian view also does not explain why school districts are not exclusive to either upper- or lower-class neighborhoods, with competition limited to a given school district.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Economies of Scale in Bureaucracy

Friedman (1962, p. 97) presented yet another explanation for providing public education rather than subsidizing private education to obtain any possible net marginal external benefits from education:

> Another factor that may have been important a century ago was . . . the absence of an efficient administrative machinery to handle the distribution of vouchers and check their use. Such machinery is a phenomenon of modern times that has come to full flower with the enormous extension of personal taxation and of social security problems. In its absence, the administration of schools may have been regarded as the only possible way to finance education.

There are several problems with Friedman's reasoning. He does not explain why vouchers are now used for so many other goods (for example, Medicaid and food stamps) but not for education. An explanation based on inertia might help answer this: programs such as Medicaid and food stamps were adopted after vouchers became feasible, but public education was adopted before they became feasible. Once a certain method of provision is adopted, it may be too costly to change. Given the large gains apparently associated with such a change and assuming that inertia is the real explanation, the implied costs of changing the system must be very large. It appears unlikely, however, that the inertia would be of such a great magnitude.

The historical record provides a much more serious objection to Friedman's contention. Education was originally subsidized under voucher-type arrangements with private schools in such areas as New York. The government initially subsidized private schools "in proportion to the average number of pupils under instruction" (West 1967, p. 106; 1980, p. 5). Friedman does not explain why the voucher system preceded public education.

Monopsony Power for Educational Inputs

Bish and O'Donoghue (1970) and Borcherding (1971) claimed that the typical public goods analysis ignores instances in which the government faces upward-sloping supply curves for inputs. The implication is that in acting as a profit-maximizing monopsonist, the government underproduces public goods and pays inputs less than their marginal revenue product. The possibility of earning such monopsony rents created incentives for producers (that is, the government) to create monopsonies (Shibata 1973).

While no one has applied this argument explicitly to education, pay raises do attract additional public educators, and since higher salaries would also have to go to present educators, the marginal

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

outlay for additional teachers would be higher than the educators' salaries. In fact, educators state that higher wages are necessary to attract higher quality teachers.[19]

However, a simple test shows that public education was not introduced to create a monopsony for educational inputs. If such a hypothesis were true, we should observe both lower costs of education and lower teacher salaries. Since both are higher for public schools relative to private schools, this hypothesis must be rejected. Private schools would have an incentive to "chisel" on the monopsony arrangement by paying teachers higher prices and thus attracting those of higher quality. Public school teachers earn approximately 28 percent more than private teachers (see Table 3).

Any comparison of public and private teacher salaries will be objected to because the differences are not standardized for the amount of work required. Table 3 adjusts for this by showing the ratio of public to private teacher salaries divided by the ratio of pupils per teacher in public to private schools. This adjustment still leaves salaries of public school teachers 20 percent higher than their private school counterparts. Proponents of the monopsony explanation may

TABLE 3

EVIDENCE OF GOVERNMENT AS A MONOPSONIST

Region	Teachers' Salaries 1982–83 (1) Public	(2) Private	Pupils per Teacher 1981/82 (3) Public	(4) Private	Ratio of (1)/(2)	Ratio of (1)/(2) to (3)/(4)
New England	18,812	15,536			1.211	
Mideast	23,083	16,188			1.426	
Southeast	17,715	14,519			1.220	
Great Lakes	21,755	17,056			1.276	
Plains	18,930	17,547			1.079	
Southwest	19,294	18,069			1.068	
Rocky Mountains	20,545	17,352			1.184	
Far West	23,612	17,660			1.337	
USA Average	20,531	16,103	18.89	17.87	1.275	1.206

SOURCES: *Statistical Abstract of the United States* (1984, p. 150); *United States Catholic Elementary and Secondary Schools, 1981–1982; USA Today* (17 March 1983): 2A.

[19]See *USA Today* (8 May 1984): 11A.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

argue that this differential is caused by the higher quality of public school teachers. This contention is, however, contradicted by evidence presented above on the relative quality of the two systems.

Given that the teachers serve the same market and that the supply and demand for teachers in both the public and private sectors are in equilibrium, how can real wages differ? As already discussed, Hanushek (1972) noted that public teachers are required to invest in activities that do not improve their teaching skills. The imposition of more stringent requirements as a prerequisite to obtain the higher salaries associated with public schooling shifts back the supply curve in that sector. If these requirements do not raise the skill level of teachers in other activities (for example, teaching in private schools), the differences in public and private school salaries must be regarded as a rent public school teachers receive. But why do they receive such a rent?

Imperfect Capital Markets

Alfred Marshall was probably the first economist to point out that imperfect capital markets can lead to an underinvestment in a child's education: "Those who bear the expenses of rearing and educating him receive but very little of the price that is paid for his services in later years" (in Thompson and Ruhter 1981, p. 3).

Pigou (1920), Friedman (1962), and Nerlove (1975) also recognized that most types of loans require collateral provisions that provide lenders compensation in the event of a loan default. Antislavery laws, however, prevent repossession of investment in human capital, and this makes educational loans riskier. Hence, even where an investment in someone's education would yield a high rate of return (in the form of increased future earnings), loans may not be made because of the problems of enforcing repayment. The implication is that, if left to itself, society will underinvest in education. Though such underinvestment would not be a problem in a completely laissez-faire society, it does arise in the presence of certain laws.

Leffler and Lindsay (1982, p. 7), in their examination of the health care industry, pointed out that methods other than public provision of medical schools are available to solve this problem. Their list includes "offering tax deductions or direct subsidies to the purchase of care, by offering subsidies to medical schools which lower fees, subsidies (scholarships) to students, or interest subsidies to the lenders themselves." They found (pp. 18–20) that it is much less costly to subsidize training than to subsidize consumption. Their conclusion is based on the assumption that the government's social discount

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

rate is less than the medical applicants' subjective cost of delaying consumption, estimated to be about 10 percent for the period 1952–76. Their results seem equally applicable to other types of education.

Education as Indoctrination

The previous discussions relating crime and democracy to education have brought out the often explicit use of indoctrination by advocates of public schooling. The use of public education to instill certain religious views has long been widely accepted in many countries. Political indoctrination through schooling has an equally long history.

In many countries, public education often began at the instigation of churches (Tullock 1983, p. 140). In the United States, public education was for a long period openly religious. "In fact, the very growth of the Catholic school system was a result of the feeling that a majority view of religion and morality was being imposed through government schools that was in opposition to the minority beliefs of Catholics" (Spring 1982, p. 89). Field (1974, p. 52) cited school committee reports in Massachusetts requesting that teachers "impress some moral or religious instruction" on their students. Private religious schools in New York were subsidized during the early 19th century (West 1967, p. 106). Nasaw (1979, p. 40) stated, "The common school education would be a moral education."

The use of publicly provided education to instill political views seems no less explicit. Nasaw (1979, pp. 40–41) discussed how "Whig prejudices color[ed] the presentation of most issues" in early American public school history books. Even Thomas Jefferson "proposed to censor and control the political texts at the University of Virginia. His fear here was the possible teaching of his political enemy, federalism" (Spring 1982, p. 83).

In England the Utilitarians worried not so much that children were not receiving education, but that they were obtaining "the wrong sort of education" (West 1980, p. 5). West (1970, p. 127) examined why the desire to spread literacy was not always the guiding principle in British government actions. He noted:

> On this subject most modern specialists seem to be agreed and the documentary evidence is abundant. The frightened reactions of early 19th century English governments against the spread of political literature among the "lower orders" took the form of fiscal and legal action against the spread of newspapers especially those critical of government.

Marxist claims of indoctrination (Field, Bowles, and Gintis) have been examined above. Bethell (1983) and Lott (1986) provided con-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

temporary evidence of inculcation of views. High (1985, pp. 309–11) provided a useful survey of the debate by economists concerning the use of state education to instill "values essential to a good society." Overall, the belief that public provision can be used to instill certain views is overwhelmingly accepted and is well-supported by the evidence.

A Possible Alternative View

Only the use of education to indoctrinate appears difficult to dismiss. It is still necessary, however, to specify the gains politicians receive from inculcating values. Virtually all government actions create wealth transfers, even when such actions solve free-riding problems. Moreover, when manipulating the size and distribution of such transfers, politicians act to maximize support. Utility-maximizing models of political behavior consistent with microeconomic theory have focused on the costs faced by the opposition and the benefits from the support these transfers create (Downs 1957; Buchanan and Tullock 1962; Stigler 1971; Peltzman 1976). What appears lacking in the literature is the analysis of specific investments governments make to enhance the support and/or mitigate the opposition arising from transfers.

Traditionally, political entrepreneurs are assumed to maximize a political support function consisting of the number of net gainers and net losers from government policy and the probability these respective groups will throw their support for or against the politicians. In turn, these probabilities depend on the size of the net transfers. This maximization procedure is performed subject to the costs of creating the transfers, such as organizing the groups that gain from the transfers. The politicians who gain the highest level of support win, given the technology of marshalling political constituencies. Innovations can also be made by the politicians in lowering the cost of making transfers.

One possible method of lowering the cost of transfer payments is to instill certain ideological beliefs—for example, the perceived legitimacy of the existing transfers. If individuals believe that the government is "fair" and "legitimate," the costs of undertaking government actions are reduced. Assuming that citizens have imperfect information and that additional information, including misinformation, will change behavior, then it does not matter whether this inculcation consists of changing tastes or holding them constant. The vigorous debate over ideology versus self-interest as an explanatory model aside (Stigler and Becker 1977; Kau and Rubin 1978, 1979;

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Kalt and Zupan 1984; Lott 1987c, 1987d; Peltzman 1984), the outcome is the same. If people's views depend on the information they receive, it follows that changes in the relative costs of receiving information produce different views. Indoctrination, or "socialization," might serve as a substitute for expenditures on police in mitigating opposition. This sort of alternative investment does not need to arise from conscious plans to lower the costs of wealth redistributions by governments but can emerge as a "survival" characteristic. Governments making transfers at the lowest costs are challenged less frequently than others. Over time, governments exhibiting the characteristics associated with the lowest cost methods of action taking should grow larger and more numerous.

Government control over media and education changes the mix of information people receive. By raising the cost of antitransfer information and lowering the cost of protransfer information, views more sympathetic to transfers are produced. The level of opposition arising from a certain level of transfers can be mitigated by using force (totalitarianism) or indoctrination (education).[20] The higher the level of transfers, the greater the opposition and thus the greater the return to indoctrination. Likewise, if totalitarianism also makes people worse off by restricting their real opportunity set and raising the level of opposition, then, under certain conditions, the return to education will increase with the level of totalitarianism. In fact, Lott (1986) found both of these predictions to be true across 90 countries in 1975 and 41 in 1977. As noted above, the standard public goods explanation for democracy predicts the opposite relationship between totalitarianism and education. Leaders of totalitarian countries would avoid creating a more independent and critically reasoning constituency.

Lott (1984, 1987a) has shown that the returns to other investments used in producing this information can also vary predictably with the level of totalitarianism. One such investment can involve higher real salaries that public educators receive. Treating educators as any other interest group, however, will not explain why public provision is used for education. In terms of the indoctrination theory, the threatened loss of higher earnings can serve as a complement to exclusive territories in ensuring that the desired information is pro-

[20]Totalitarianism in the model is seen as having two essential characteristics: (1) the more costly it is for opposition groups to oppose government policy, the more totalitarian a country is defined to be; (2) totalitarianism is viewed as being similar to a tax in that it restricts people's real opportunity set. Higher levels of totalitarianism, like higher levels of taxes, make people worse off and generate more opposition to the ruling coalition.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

duced. The loss of this income stream need not be explicitly linked to the information produced by educators in order to influence their behavior. Educators concerned about maintaining their earnings may produce information to defend their status.

Lott (1984, 1987b) found that the rents vary systematically among teachers in white and nonwhite school systems in South Africa. The wealth transfers to educators argument would seem to predict that since white teachers in South Africa have the greatest political power, they should be the most successful in lobbying for higher salaries. Instead, Lott's studies found that those with supposedly the least to gain from supporting the government—nonwhites teaching in the three nonwhite school systems—receive the larger rents. The hypothesis advanced here is consistent with precisely such a result since it predicts that the return to indoctrination is highest among nonwhite students.

Conclusion

The conventional explanations for publicly provided education are inadequate: they do not present a general theory of public provision; they do not explain why public provision is essential to their arguments; and they fail to consider the historical record. In their place, I have suggested that governments willingly bear the costs associated with public provision because it reduces the costs of other government actions—in particular, the costs of transferring wealth.

References

Alchian, Armen A., and Kessel, Reuben A. "Competition, Monopoly, and the Pursuit of Money." In *Aspects of Labor Economics*, pp. 157–75. Princeton, N.J.: Princeton University Press, 1962.

Alchian, Armen A. "Some Economics of Property Rights." *Il Politico* 31, no. 4 (1965): 816–29.

Alchian, Armen A. "The Economic and Social Impact of Free Tuition." *New Individualist Review* 5 (Winter 1968): 42–52.

Becker, Gary S. "Comment on Schooling and Inequality from Generation to Generation." *Journal of Political Economy* 80 (June 1972): S252–55.

Becker, Gary S., and Chiswick, Barry R. "Education and the Distribution of Earnings." *American Economic Review* 56 (May 1966): 358–69.

Bethell, Tom. "Liberation Literacy: But Can Juanito Really Read?" *National Review* (30 September 1983): 1196–99.

Bish, Robert L., and O'Donoghue, Patrick D. "A Neglected Issue in Public Goods Theory." *Journal of Political Economy* 78 (November/December 1970): 1367–71.

Borcherding, Thomas E. "A Neglected Social Cost of a Voluntary Military." *American Economic Review* 61 (March 1971): 195–96.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Borcherding, Thomas E.; Pommerehne, Werner W.; and Schneider, Friedrich. "Comparing the Efficiency of Private and Public Production: The Evidence from Five Countries." *Zeitschrift für Nationalökonomie* 42, suppl. 2 (1982): 127–56.

Bowles, Samuel. "Schooling and Inequality from Generation to Generation." *Journal of Political Economy* 80 (June 1972): S219–51.

Bowles, Samuel. "Understanding Unequal Economic Opportunity." *American Economic Review* 63 (May 1973): 346–56.

Bowles, Samuel, and Gintis, Herbert. *Schooling in Capitalist America: Educational Reform and the Contradictions of Economic Life.* New York: Basic Books, 1976.

Bredeweg, Frank H. *United States Catholic Elementary and Secondary Schools: 1981–1982.* Washington, D.C.: National Catholic Educational Association, 1982.

Buchanan, James M., and Tullock, Gordon. *The Calculus of Consent.* Ann Arbor, Mich.: University of Michigan Press, 1962.

Chiswick, Barry. "Minimum Schooling Legislation and the Cross-Sectional Distribution of Incomes." *Economic Journal* 79 (1969): 495–507.

Coase, Ronald. "The Market for Goods and the Market for Ideas." *American Economic Review* 64 (May 1974): 384–91.

Cohn, Elchanan. *The Economics of Education.* Cambridge, Mass.: Ballinger, 1979.

Coleman, James S.; Hoffer, Thomas; and Kilgore, Sally. *High School Achievement: Public, Catholic, and Private Schools Compared.* New York: Basic Books, 1982.

Cox, Donald, and Jimenez, Emmanuel. "Private-Public Differences in Secondary School Performance: The Role of Selection Effects in Columbia and Tanzania." Working Paper. Washington University, St. Louis, 1987.

Davis, Lance E., and North, Douglas C. *Institutional Change and American Economic Growth.* Cambridge, Mass.: Cambridge University Press, 1971.

Demsetz, Harold. *Economic, Legal, and Political Dimensions of Competition.* New York: North-Holland, 1982.

Downs, Anthony. *An Economic Theory of Democracy.* New York: Harper, 1957.

Field, Alexander James. "Educational Reform and Manufacturing Development in Mid-Nineteenth Century Massachusetts." Ph.D. diss., University of California, Berkeley, 1974.

Fishlow, Albert. "The American Common School Revival, Fact or Fancy?" In *Industrialization in Two Systems: Essays in Honor of Alexander Gerschenkron,* pp. 40–67. Edited by Henry Rosovsky. New York: John Wiley and Sons, 1966.

Friedman, Milton. "The Role of Government in Education." *Economics and the Public Interest,* pp. 123–53. Edited by Robert Solow. New Brunswick, N.J.: Rutgers University Press, 1955.

Friedman, Milton. *Capitalism and Freedom.* Chicago: University of Chicago Press, 1962.

Friedman, Milton. "Are Externalities Relevant?" In *Nonpublic School Aid,* pp. 92–93. Edited by E. G. West. Lexington, Mass.: Lexington Books, 1976.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Gintis, Herbert. "Education, Technology, and Characteristics of Worker Productivity." *American Economic Review* 61 (May 1971): 266–79.

Grubb, W. Norton. "The Distribution of Costs and Benefits in an Urban Public School System." *National Tax Journal* 24 (March 1971): 1–11.

Gurwitz, Aaron Samuel. "The Capitalization of School Finance Reform." *Journal of Educational Finance* 5 (Winter 1980); 297–319.

Gurwitz, Aaron Samuel. *The Economics of Public School Finance.* Cambridge, Mass.: Ballinger, 1982.

Guthrie, James W. "United States School Finance Policy 1955–1980." In *School Finance Policies and Practices, The 1980's: A Decade of Conflict.* Edited by James Guthrie. Cambridge, Mass.: Ballinger, 1980.

Hansen, Whittier Lee, and Weisbrod, Burton A. *Benefit Costs and Financing of Public Higher Education.* Chicago: Markham Publishing Co., 1969a.

Hansen, Whittier Lee, and Weisbrod, Burton A. "The Distribution of Costs and Direct Benefits of Public Higher Education: The Case of California." *Journal of Human Resources* 4 (1969b): 176–91.

Hanushek, Eric. *Education and Race: An Analysis of the Educational Production Process.* Lexington, Mass.: D. C. Heath, 1972.

Hanushek, Eric. "The Economics of Schooling." *Journal of Economic Literature* 24 (September 1986): 1141–77.

Heidenheimer, Arnold J. "Education and Social Security Entitlements in Europe and America." In *Development of Welfare States in Europe and America,* pp. 269–306. Edited by Peter Flora and Arnold Heidenheimer. New Brunswick, N.J.: Transaction Books, 1982.

High, Jack. "The Market, State, and Education," chap. 5. Manuscript, 1984.

High, Jack. "State Education: Have Economists Made a Case?" *Cato Journal* 5 (Spring/Summer 1985): 305–23.

Huntford, Roland. *The New Totalitarians.* New York: Stein and Day, 1980.

Kalt, Joseph P. "Public Goods and the Theory of Government." *Cato Journal* 1 (Fall 1981): 565–84.

Kalt, Joseph P., and Zupan, Mark A. "Capture and Ideology in the Economic Theory of Politics." *American Economic Review* 74 (June 1984): 279–300.

Kau, James B., and Rubin, Paul H. "Voting on Minimum Wages: A Time-Series Analysis." *Journal of Political Economy* 86 (April 1978): 337–46.

Kau, James B., and Rubin, Paul H. "Self-Interest, Ideology, and Logrolling in Congressional Voting." *Journal of Law and Economics* 22 (1979): 365–84.

Kohn, Melvin L. *Class and Conformity.* Homewood, Ill.: Dorsey Press, 1969.

Lazear, Edward. "Intergenerational Externalities." *Canadian Journal of Economics* 16 (1983): 212–28.

Levin, Henry M. "Educational Vouchers and Social Policy." In *School Finance Policies and Practices: The 1980's.* Edited by James Guthrie. Cambridge, Mass.: Ballinger, 1980.

Leffler, Keith B., and Lindsay, Cotton M. "Student Discount Rates, Consumption Loans and Subsidies to Professional Training." Working Paper no. 132. University of California, Los Angeles, November 1982.

Lepage, Henri. "Will Private Education Continue to Exist in France?" *Wall Street Journal,* 11 May 1983, p. 29.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Lott, John R. "Alternative Explanations for Public Provision of Education." Ph.D. diss., University of California, Los Angeles, 1984.
Lott, John R. "Education, Democracy, and the Cost of Government Wealth Transfers." Working Paper. Hoover Institution, Stanford, 1986.
Lott, John R. "The Institutional Arrangement of Public Education: The Puzzle of Exclusive Territories." *Public Choice* 54 (1987a): 89–96.
Lott, John R. "The Institutional Arrangement of Public Education: The Rents to Public Educators." Working Paper. Hoover Institution, Stanford, 1987b.
Lott, John R. "The Effect of Nontransferable Property Rights on the Efficiency of Political Markets: Some Evidence." *Journal of Public Economics* 32 (1987c): 231–46.
Lott, John R. "Political Cheating." *Public Choice* 52 (1987d): 169–86.
Lott, John R. "Juvenile Delinquency and Education: A Comparison of Public and Private Provision." *International Review of Law and Economics* 7 (December 1987e): 163–75.
Mill, John Stuart. *Principles of Political Economy*. 1848. Reprint. Clifton, N.J.: Augustus M. Kelley, 1973.
Mitchell, Brian R. *European Historical Statistics 1750–1970*. New York: Columbia University Press, 1975.
Montgomery, Zack. *Anti-Parental Education*. San Francisco, 1878.
Nasaw, David. *Schooled to Order: A Social History of Public Schooling in the United States*. New York: Oxford University Press, 1979.
Nerlove, Marc. "Some Problems in the Use of Income-Contingent Loans for the Finance of Higher Education." *Journal of Political Economy* 83 (February 1975): 157–83.
Peltzman, Sam. "The Effect of Government Subsidies-in-Kind on Private Expenditures: The Case of Higher Education." *Journal of Political Economy* 81 (January/February 1973): 1–27.
Peltzman, Sam. "Toward a More General Theory of Regulation." *Journal of Law and Economics* 19 (August 1976): 211–40.
Peltzman, Sam. "Constituent Interest and Congressional Voting." *Journal of Law and Economics* 22 (April 1979): 181–210.
Philips, Llad; Votey, Harold L.; and Maxwell, Donald. "Crime, Youth, and the Labor Market." *Journal of Political Economy* 80 (May/June 1972): 491–504.
Pigou, Arthur C. *Economics of Welfare*. London: Macmillan, 1920.
Rowley, Charles K., and Peacock, Alan T. *Welfare Economics: A Liberal Restatement*. New York: John Wiley and Sons, 1975.
Savas, Emanuel S. *Privatizing the Public Sector*. Chatham, N.J.: Chatham House, 1982.
Shibata, Hirofumi. "Public Goods, Increasing Cost, and Monopsony: Comment." *Journal of Political Economy* 81 (January/February 1973): 223–30.
Singer, Neil. "Criteria for Public Investment in Education." In Joint Economic Committee Report, U.S. Congress, *The Economics and Financing of Higher Education in the United States*. Washington, D.C.: Government Printing Office, 1972.
Smith, Adam. *An Inquiry into the Nature and Causes of the Wealth of Nations*. 1776. Reprint. Modern Library ed. New York: Random House, 1937.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Spring, Joel. "The Evolving Political Structure of American Public Schooling." In *The Public School Monopoly*. Edited by Robert B. Everhart. Cambridge, Mass.: Ballinger, 1982.

Staaf, Robert J. "The Public School System in Transition." *Budgets and Bureaucrats: The Sources of Government Growth*, pp. 130–47. Edited by Thomas E. Borcherding. Durham, N.C.: Duke University Press, 1977a.

Staaf, Robert J. "The Growth of the Educational Bureaucracy: Do Teachers Make a Difference?" In *Budgets and Bureaucrats: The Sources of Government Growth*, pp. 147–68. Edited by Thomas E. Borcherding. Durham, N.C.: Duke University Press, 1977b.

Stapleton, D. C. "External Benefits of Education: An Assessment of the Effect of Education on Political Participation." *Sociological Methodology*, 1978.

Stigler, George J. "Director's Law of Public Income Redistribution." *Journal of Law and Economics* 13 (April 1970): 1–12.

Stigler, George J. "The Theory of Economic Regulation." *Bell Journal of Economics and Management Science* 2 (Spring 1971): 3–21.

Stigler, George J., and Becker, Gary S. "De Gustibus Non Est Disputandum." *American Economic Review* 67 (March 1977): 79–90.

Thompson, Earl, and Ruhter, Wayne. "Parental Malincentives and Social Legislation." UCLA Working Paper No. 144, 1981.

Toma, Eugenia F. "Institutional Structures, Regulation, and Producer Gains in the Education Industry." *Journal of Law and Economics* 26 (April 1983): 103–16.

Tullock, Gordon. *Economics of Income Redistribution*. Boston: Kluwer-Nijhoff, 1983.

Webb, R. K. "The Victorian Reading Public." In *From Dickens to Hardy*. Edited by Borris Ford. Pelican, 1963.

Weisbrod, Burton A. "Education and Investment in Human Capital." *Journal of Political Economy* 70 (October 1962): 106–23.

Weisbrod, Burton. *External Benefits of Public Education*. Princeton: Princeton University Press, 1964.

West, E. G. "The Political Economy of American Public School Legislation." *Journal of Law and Economics* 10 (1967): 101–28.

West, E. G. *Economics, Education, and the Politician*. Norwich: Institute of Economic Affairs, Soman-Wherry Press, Ltd., 1968.

West, E. G. *Education and the State*. 2d ed. London: Institute of Economic Affairs, 1970.

West, E. G. "Education and Crime: A Political Economy of Interdependence." *Character* 1 (June 1980): 4–7.

West, E. G. "Are American Schools Working? Disturbing Cost and Quality Trends." *Policy Analysis* No. 26, Cato Institute, 9 August 1983.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Support of the Elderly before the Depression: Individual and Collective Arrangements

Carolyn L. Weaver

Introduction

Before the Great Depression, the care of the poor of all ages was a responsibility assumed primarily by the private sector, generally through the extended family, friends and neighbors, and organized private charity.[1] As late as 1927, when welfare expenditures by all levels of government amounted to less than $200 million, nearly all of which was state and local spending on indoor relief, private philanthropy was estimated to exceed a billion dollars (see Bureau of Census 1975, pp. 1120–28). There were no federal programs (other than veterans programs) to assist the poor, whether young or old, disabled or unemployed. The role of the government in preventing poverty through the provision of pensions and insurance was even more limited.

With the onset of the Great Depression, all of this changed. As unemployment rose and the federal government stepped in to provide assistance, the number of people receiving government relief climbed to 15 million in 1933. Two years later, President Franklin Roosevelt signed into law the Social Security Act—a comprehensive piece of legislation authorizing social insurance for the aged, compensation for unemployed workers, and federal matching funds for old-age assistance, maternal and child welfare, public health, aid to dependent children, and assistance for the blind. Public welfare expenditures by all levels of government jumped to $1 billion in 1938, one-third of which was federal money, and most of which was

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.

The author is Resident Scholar at the American Enterprise Institute. An earlier version of the paper was presented at the Cato Institute-Liberty Fund Conference on Liberty and Security: The Privatization of Social Welfare, December 10–12, 1986.

[1]This paper draws on Weaver (1983); see also Weaver (1982).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

in the form of cash assistance. By 1940, a quarter of a million people were receiving cash support under the insurance titles of the Social Security Act financed by a compulsory tax on more than 30 million workers.[2] This expansion by the federal government was not to be reversed.

Apart from profoundly altering the role of government, the Depression helped forge—for better or worse—a lasting impression about how the world works, one that may have more to do with the perpetuation of government programs than any particular act of Congress. Consider the words of Thomas P. O'Neill, Jr. (1985, pp. 482–85), former Speaker of the House, describing life in America 50 years ago:

> This country is a desperate place. Half the people live in poverty. Twenty-five percent of the workforce are unemployed. Life is little better for those working. . . . Life for the elderly is filled with uncertainty, dependency and horror. When you get old, you are without income, without hope. Only the lucky few have pensions. Social Security does not exist.

It is but a short step to the conclusion that if it were not for Social Security, conditions today would be like they were in the 1930s. In O'Neill's words,

> Social Security has made it possible for people . . . not to have to live in fear and dependency. Without such protection, half of those people living on Social Security would be living in poverty.

A snapshot in time, during the greatest economic calamity in this nation's history, is taken as the measure of how the world worked before federal government intervention. In turn, the proper role of the federal government today is defined by the role it assumed then.

This paper is an attempt to take a fresh look at the support of the aged prior to the Great Depression and to question what is now taken for granted: that private financial institutions, in combination with public and private assistance for the poor, were unable to accommodate the retirement income needs of the elderly. In seeking to shed light on this issue, the following questions are explored: How extensive was poverty among the elderly, and what were the prevailing methods, both public and private, for alleviating it? How was society organized to handle the problems of the aged, either the ex post problem of poverty or the ex ante problem of retirement planning? What arrangements were available to pool risk and redistribute

[2]Bureau of Census (1975, pp. 1120–28); see also U.S. Committee on Economic Security (1934), U.S. Social Security Board (1940, p. 6.), and Social Security Administration (1985).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

income over one's lifetime? How might these institutions have evolved in the absence of federal intervention? Finally, is there evidence of an unmet need that could be satisfied only by compulsory, federal social insurance? I begin this investigation with a review of early views on the problems of the elderly and the proposed remedy, social insurance.

Early Views on the Problem of Old-Age

Social reformers in the early decades of this century had a view of the elderly and their plight that was not unlike O'Neill's. The "problem of old-age"—variously described as the "tragedy," the "universal problem," and the "haunting fear in the winter of life"—was poverty resulting in dependency on others, whether private or public charity, or ultimately the public almshouse.[3] The source of the problem was said to be the modern industrial state and the worker's complete dependence on wage income. According to Abraham Epstein (1938, p. 3) of the American Association for Old-Age Security,

> The challenge facing us in the twentieth century is that of economic insecurity, which weighs down our lives, subverts our liberty, and frustrates our pursuit of happiness. . . . Our modern system of industrial production has rendered our lives insecure to the point of despair. The wage system has made economic security depend entirely on the stability of our jobs.

Because wages were low and insurance and pensions were costly or unavailable to industrial workers, the argument continued, saving was a "practical impossibility," and the interruption of earnings in old age was cataclysmic. The only resolution to the problem of old age, said Barbara Armstrong (1932, p. 381), a leading figure in the social insurance movement, was "to leave this world early before the period of superannuation set in."

While it might have been reasonable to conclude that the outlook for the elderly would improve over time, social insurance advocates argued just the opposite. Industrialization would combine with rising life expectancies to produce the "iron law" of old-age dependency. A growing proportion of the aged would be dependent and, as a group, the aged would live in dependency for a longer period of time.

Social reformers of the day advocated two types of programs to deal with the problem. As a temporary measure, they sought a federal program of old-age assistance, or means-tested welfare. As a permanent solution to the problems of the aged, they sought a compulsory,

[3]See, for instance, Armstrong (1932), Epstein (1938), and Rubinow (1916, 1932).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

federal program of old-age insurance. Under such a program, industrial workers would be provided a pension in old age, subsidized from the general fund of the treasury. Programs such as these had been introduced in Europe in the 1880s and 1890s and were prevalent by the 1920s.

The concerns raised by the reformers were given a serious hearing in the 1920s. By then, the care of the aged was a leading social issue, and the various proposals for government action were subject to intense public debate and inquiry. With the prompting of the American Association of Labor Legislation and the American Association for Old-Age Security, 13 states commissioned studies on the financial condition of the elderly and the desirability of government action. Proposals to aid the elderly were debated in most state legislatures.[4]

The growing concern over the aged coincided with important economic and demographic changes at the turn of the century. The movement of the population from the farm to the city and the change in employment from the agricultural sector to the industrial threatened the foundations of income support in old-age: continued employment and the extended family. Between 1880 and 1920, the proportion of men employed in agriculture dropped 31 percent among those under 65 and 39 percent among the elderly. Overall, the proportion of elderly men employed fell from 73 percent to 60 percent (Latimer 1930). In addition, there were growing numbers of the elderly with whom to contend. Between 1880 and 1930, the proportion of the population 65 and older rose from 3.4 percent to 5.4 percent, and life expectancy at birth (for white males) jumped from 41 to 61 years. The odds that a 20-year old would live to age 65 first exceeded 50:50 at the turn of the century.[5]

Evidently, new ways of caring for the aged and providing for retirement were appropriate. Whether or not there was a role for the federal government remained to be demonstrated.

Demise of the Social Insurance Movement

The idea that compulsory old-age insurance was "the solution" to "the problem" of old age was given a fair hearing during the 1920s and it was rejected. At a time when poverty relief was predominantly a private activity supplemented by local government assistance and when the insurance industry was thriving, proposals for compulsory,

[4]See New York Commission on Old-Age Security (1930), U.S. Committee on Economic Security (1934), "Status of Old-Age Pension Legislation in the United States" (1929), and Johnson (1935, pp. 39–740).

[5]See Bureau of Census (1975), and Darby (1979, p. 23).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

federal action were denounced in the strongest terms possible. Samuel Gompers (1917, p. 198), president of the American Federation of Labor, rejected social insurance as "in its essence undemocratic." In 1916, he vowed to assist in the "inauguration of a revolution against compulsory insurance."[6] The response of business groups was no more favorable. In language common at the time, the Pennsylvania Chamber of Commerce in 1924 described compulsory public schemes to aid the elderly (including welfare) as "un-American and socialistic and unmistakably earmarked as an entering wedge of communist propaganda."[7] Of the 21 reports prepared by state commissions, only one endorsed social insurance. At the federal level no bills for compulsory old-age insurance were even introduced into Congress.

As the 1920s came to a close, the social insurance movement in the United States was an acknowledged defeat—"practically untouched, irrelevant and meaningless, a mirage in a sunlit sea of prosperity," as one supporter admitted.[8] The situation here stood in sharp contrast with that prevailing in Europe and other parts of the world, where national schemes to aid the elderly had become widespread.

A More Realistic Assessment of the Elderly

What killed compulsory old-age insurance in this country was the failure of advocates to define a problem that could withstand careful scrutiny and to offer resolutions that contained more promise than the evolving system of income support. How, after all, could social insurance reverse the process of industrialization, raise wages, improve family solidarity, or be less subject to financial difficulties than state and local pension systems? Furthermore, the picture of the elderly portrayed by social insurance advocates was not borne out by the evidence.

Based on the available evidence, a snapshot of the elderly in the 1920s might look something like this: There are 5.8 million people aged 65 and older, about 5 percent of the U.S. population. Most of them live in their own homes, most are self-supporting, and among those who are not, the vast majority are cared for by family members. The primary source of support in old-age is earnings from continued employment; most elderly men work. Other sources of support in retirement or upon the death of the breadwinner are life insurance,

[6]Cited in Lubove (1968, p. 16).

[7]Cited in Lubove (1968, p. 139).

[8]Leifer Magnusson, International Labor Office, cited in Lubove (1968, p. 113).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

pensions, and annuities, not to mention family members and friends. Public pensions for teachers, firemen, and policemen are provided by most cities; military and civil service pensions are provided by the federal government; and private pensions are emerging. There are some benevolent homes for the aged and the public almshouse is still in use, but reliance on organized private and public charity is rare. For those in need, the family is the "safety net."

More important, things are very much in a state of flux. In the private sector, pensions are becoming more prevalent; life insurance and pension arrangements are improving; and benevolent homes—the precursors to modern nursing homes—are sprouting up around the country. In the public sector, opposition to cash assistance for the elderly poor is withering, and the states are beginning to adopt old-age assistance programs. The ability of private and local public institutions to respond to the problems of the aged is striking.

The Pattern of Support and the Extent of Poverty

Because of the very limited role played by the federal government in providing poverty relief prior to the Depression (and the absence of a federal income tax prior to 1913), there are no extensive national statistics on the income and assets of the elderly in the 1920s.[9] The most detailed information I have been able to locate is contained in a series of reports prepared by the state commissions created to study the economic circumstances of the elderly. Particularly useful are the reports of the Massachusetts Commission (completed in 1925) and the New York Commission (completed in 1929). Both were large studies judged to be useful in evaluating old-age dependency in other areas.[10] Surveys conducted by the National Civic Federation are also informative. A careful examination of these studies along with other known facts about financial institutions provide valuable insights

[9]Beginning in 1902, the Bureau of Census was prohibited from enumerating and investigating the poor other than those in almshouses.

[10]Measuring poverty with precision and determining the causes of poverty are always difficult tasks. They were particularly difficult in the 1920s because the elderly had been raised before the day of the federal income tax and before payment in cash wages was the rule. Recurring problems in then-current studies were the treatment of individuals in couples and the treatment of individuals without their own sources of income. In some studies the total income of a couple was attributed to both individuals. In others, the total income of the couple was attributed entirely to one person (in the case of earnings, to the person who worked) and the other person was assumed to have no income at all. Some of the major studies of the period used this latter technique, thereby counting most wives as "dependent" on their husbands. Under either technique, an elderly couple living comfortably with its children, would, if it did not have its own source of income, be counted as poor and dependent.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

into the nature of the problem of old age and political sentiments toward its resolution.

Table 1 summarizes the pattern of support among the aged in New York.[11] As shown, of the 603,700 elderly people residing in the state in 1929, an estimated 90 percent were self-supporting or supported by friends and family. Of these, most were self-supporting on the basis of earnings, pensions, or other income. (Actually, an estimated 43.6 percent of the aged were self-supporting, but this figure counted as "dependent" all wives without their own sources of income.) The primary source of support among the aged was earnings. Less than 4

TABLE 1

SURVEY FINDINGS ON SUPPORT OF AGED POPULATION IN NEW YORK

Class	Persons Sixty-Five and Older		Persons Seventy and Older	
	Number	Percent	Number	Percent
Estimated Total	603,700	100.0	350,400	100.0
Self-Dependent	263,507	43.6	126,535	36.0
Public Pensions[a]	50,390	8.3	38,478	11.0
Private Pensions	10,937	1.8	10,557	3.0
Current Earnings (excluding housewives)	172,000	28.5	60,000	17.0
Income	30,180	5.0	17,500	5.0
Dependent on Friends and Relatives (including housewives):	303,753	50.4	199,802	57.1
Dependent on Organized Charity:				
Public	12,924	2.1	9,095	2.6
Private	8,421	1.4	6,740	1.9
Confined by Government[b]	15,104	2.5	8,228	2.4

[a]Federal civil and military retirement pensions, state and local retirement pensions, and military homes.

[b]Includes inmates of mental institutions and prisons. Those in almshouses are placed under "dependent on organized public charity."

SOURCE: New York Commission on Old-Age Security (1930, p. 39).

[11]The New York study was the last major study prior to the Depression. Amounting to 700 pages, it provides an exhaustive and informative look at conditions and institutions prevailing in New York. See New York Commission on Old-Age Security (1930).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

percent of the state's elderly were found to be dependent on organized public or private charity: 2.1 percent were in public almshouses and 1.4 percent received private charity. The balance, 2.5 percent, were confined in mental institutions or prisons. The Massachusetts Commission on Pensions reported similar findings.

There was poverty among the elderly, of course, just as there was poverty among people of all ages. According to surveys conducted in New York and Massachusetts, 10–20 percent of the elderly were in need of assistance, as evaluated by the standards of the time. These were people who had inadequate property (less than $5,000) and inadequate income (less than $400 annually) and who were without financially responsible children. Ignoring family status, the proportion was closer to 20–25 percent (see New York Commission 1930, pp. 48–78).

By and large, the elderly were a heterogeneous group, and their problems and circumstances differed from state to state. The proportion of elderly men who worked in 1930, for example, ranged from 47 percent in the Midwest to 75 percent in the South. In the Northeast, 48 percent of the elderly in public institutions were foreign born, whereas in the South, 30 percent were black. The proportion of the elderly in the overall population varied widely as well, from just 2–3 percent in many states to more than 8 percent in some New England states.[12]

Recognizing this diversity, there was little evidence to suggest that the cause of poverty in old age was the failure of short-sighted people to plan for retirement or the failure of financial institutions to meet the demands of foresightful workers. Instead, poverty in old age seemed to result from low earnings during working years and the consequent inadequacy of savings with which to weather a reduction or interruption of earnings; it was concentrated among people with few, if any, relatives. In the New York almshouse population, for example, 80 percent of the aged had never owned a home, 37 percent were illiterate or without formal education, 90 percent were widowed or single, 73 percent were without living children, and one-third had no living relatives. In New York's overall population, three-quarters of dependent elderly men had been unskilled farm or general laborers. In California, 70 percent of the needy aged were widowed or single, two-thirds had no living children, and more than two-fifths had neither living children nor other relatives.[13]

[12]"Care of the Aged" (1930), "Extent and Distribution of Old-Age Dependency in the United States" (1934), and Bureau of Census, *Paupers in Almshouses: 1923* (1925, p. 42).

[13]New York Commission on Old-Age Security (1930, pp. 415–17), and California State Department of Social Welfare (1929, pp. 34–38).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Equally important, it was not at all clear that the magnitude of the problem would increase over the years. Industrialization and the economic growth it fostered were bringing forth real wage gains for workers as well as innovations in financial markets, and the ability of workers to make advance provision for retirement was improving. As the New York Commission (1930, p. 21) reported in 1929:

> There is a great deal of evidence which indicates that the people of this state are from generation to generation in a better economic situation . . . also that provision for the future is being made through the accumulation by individuals of large economic resources.

Private Savings, Insurance, and Pensions

Alongside the growth of real incomes in the late 19th and early 20th centuries, there was rapid growth in savings and a realignment of saving toward pensions, annuities, and life insurance. As illustrated in Table 2, the share of total personal saving accounted for by life insurance reserves and retirement pension funds rose from 7.3 percent in the period 1900–1908 to 12.1 percent in the period 1922–1929. As of 1929, total life insurance reserves stood at $17.5 billion and pension funds (public and private) stood at $2 billion.

Even more was going on than can be inferred from these aggregate figures, however. In the area of pensions and insurance, there were marked improvements for buyers in the terms of contracts, the net cost of policies, and the financial condition of providers that increased the overall attractiveness of these saving and insurance forms, particularly for low income workers.

As shown in Table 3, in 1929 there were 123 million life insurance policies in force representing $102 billion, and, in that one year alone, about $2 billion were paid out to policyholders.[14] Each of the major forms of insurance known today were in existence, providing financial protection for the elderly in a variety of ways. Policies could be purchased to provide income for the policyholder in old age, for survivors of the policyholder, or for some mix of the two. Depending on the desired mix of savings and insurance, there were term policies, whole life policies, endowment policies, and annuities. Both individual and group policies were available, and virtually no policy was too small to be written.

At the turn of the century, fraternal societies provided the dominant source of insurance protection for wage earners. Their membership

[14]Bureau of Census (1975, p. 1058). See, generally, MacLean (1935), Davis (1944), Henderson (1909), Stalson (1942), and Keeler (1963).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

TABLE 2

PERSONAL SAVING AND ITS PENSION AND INSURANCE COMPONENTS, SELECTED YEARS, 1900–1929

Year or Period[a]	Total Personal Saving[b]	Increase in Assets			
		Pension and Retirement Funds			Life Insurance Reserves
		Federal Government	State and Local	Private	
Amounts (millions of $)					
1900	1,270	—	—	—	110
1908	2,000	—	—	—	180
1914	2,550	—	—	—	200
1920	6,570	20	20	—	520
1929	11,490	160	70	160	1,120
Shares (%)					
1900–1908	100	—		—	7.3
1909–1914	100	—		—	7.1
1922–1929	100	1.6		0.5	10.0

[a]Normal periods exclude war years and recessions.
[b]Including consumer durables.

SOURCE: Bureau of Census (1975, vol. 1, pp. 266–67); Munnell (1974, pp. 39, 107).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

TABLE 3

LIFE INSURANCE POLICIES IN FORCE, 1900–1929

Year	Number (millions)	Value (billions of $)				Average Size of Policy ($)		
		Total	Ordinary	Group	Industrial	Ordinary	Group	Industrial
1900	14	7.6	6.1	—[a]	1.5	2,160	—	130
1915	41	21.0	16.7	0.1	4.3	1,800	830	130
1920	65	40.5	32.0	1.6	6.9	1,990	960	150
1925	97	69.4	52.9	4.2	12.3	2,270	1,340	170
1929	123	102.1	75.7	9.0	17.4	2,470	1,590	190

[a]Less than $500,000.

SOURCE: Bureau of the Census (1975, vol. 2, p. 1056).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

was estimated at 5.3 million, and life insurance coverage amounted to $6 billion. Societies were operated along the lines of mutual-life insurance companies and they offered low-cost insurance to members through the local lodge system. While the financial condition of fraternals was not always good, these plans were generally operating on the same reserve basis as commercial life insurance companies by the 1920s. In 1923, the assets of fraternal life insurance stood at a half billion dollars.[15]

Industrial insurance, introduced in the late 1800s, was a more recent development, and it too caught on quickly among industrial workers.[16] Policies were small, averaging $190 in 1929, and could be taken out on the life of family members at any age without medical examinations. Premiums, as low as $2 or $3 annually, could be paid on a weekly or semiweekly basis and were collected at the home of the insured. Because of the group insured (industrial workers had relatively high mortality and forfeiture rates) and the features offered, these policies were relatively expensive. Industrial insurance met a need, however, and was adopted rapidly. As of 1929, there were 82.9 million policies in force amounting to some $17 billion. Small industrial policies were even common among the elderly poor.[17]

Finally, there was group life insurance, which emerged in 1911. Group insurance allowed risks to be pooled, mitigating the problem of adverse selection and reducing screening and administrative costs. The net cost of insurance for the average worker could be reduced accordingly. During the two decades that group life insurance was available prior to the Depression, the amount in force grew at twice the rate of ordinary life insurance (see MacLean 1935; Mehr and Cammack 1976). As of 1929, group life insurance in force stood at $9 billion.

By the time social insurance was advocated in the 1920s, the life insurance industry was entering a "golden age" in which "all conditions affecting the business were good and kept getting better" (MacLean 1935, p. 497). Rising interest rates and declining mortality rates raised dividends and reduced the net cost of insurance to an all

[15]Goldsmith (1969, vol. 1, p. 462), and MacLean (1935, p. 357). See also Nichols (1917), Landis (1904), Lubove (1968, pp. 19–22), Tishler (1971, p. 23).

[16]See Stalson (1942, pp. 462–81), Davis (1944, pp. 1–11 and 318–19), McGill (1967), and MacLean (1935, pp. 385–400).

[17]In New York City, for example, an estimated 63 percent of the elderly poor had life insurance policies. Industrial life insurance policies were small, it should be noted, not only because of the market they served, but also because of legal maximums. In New York, the largest policy was $1,000 (New York Commission on Old-Age Security 1930, pp. 67, 189).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

time low. Between 1919 and 1929, the total amount of life insurance in force tripled, and both the annual amount of new insurance purchased and admitted assets doubled.[18] By this time, most states regulated the investments and reserve positions of insurance companies and controlled the essential features of their contracts.

Although a later development than life insurance, private pensions emerged around the turn of the century and grew at a rate comparable to that of life insurance. A viable market for pensions had awaited economic, demographic, and legal changes that lengthened life spans, shortened work lives, and increased returns relative to ordinary savings. As these preconditions were met in the early part of this century, the market for private pensions expanded rapidly. Workers and their employers (or unions) both stood to gain from the long-term relationship implied by pensions.

For low income workers, the important developments were in industrial pensions.[19] Introduced by the American Express Company in 1875 and the Baltimore and Ohio Railroad Company in 1880, industrial pension plans became prevalent in the railroad, public utility, iron and steel, oil, and banking industries by the 1920s. The details of plans differed, of course, but under a typical plan workers with 20–25 years of service could retire with a pension at age 65. Pension amounts generally were based on earnings, with supplements for longer service. The average pension in 1927 was $605 annually (about a third of average earnings in industrial employment). Plans were typically non-contributory, meaning employees made no direct contributions. Whereas in 1900 there were fewer than a dozen industrial pension plans, there were 440 plans by mid-1929. During the 1920s alone, the assets of private self-insured pension funds rose from $50 million to $500 million (see Goldsmith 1969, p. 468).

As shown in Table 4, there were some 5 million workers covered by private pensions in 1928, of whom 4 million were covered by industrial pensions and about 1 million were covered by union pensions. Since these plans were still quite new, relatively few people were actually collecting payments—just over 100,000 people as of 1928, as compared to over a half million beneficiaries of public pensions. In total, some 6.4 million persons, or 14 percent of the labor force, were covered by a major public or private pension plan (other than fraternals).

[18]MacLean (1935, pp. 495–99), and Bureau of Census (1975, pp. 1056–60).

[19]The best single source is Latimer (1933).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

TABLE 4

PENSION SYSTEMS IN THE UNITED STATES, 1928

Classes	Number Covered	Number of Beneficiaries
Government Employees		
Federal Executive Civil Service	568,715	14,119
State Employees	34,500[a]	1,397
Municipal Employees	93,374[b]	4,619
Teachers		
State	317,835	13,094
City	54,776	3,949
Carnegie Fund (including teachers' widows)	—	922
Policemen and Firemen	67,765	20,327
U.S. War Pensioners	—	491,194
Industrial Pensions (including railroads)	4,000,000	80,000
Trade Union Benefits		
Pensions	640,000	11,509
Disability for Old Age	352,000	—
Superannuation Benefits	143,000	—
YMCA and YWCA Secretaries	4,707	312
Ministers	—	28,319

[a]Figures for Connecticut, Massachusetts, New Jersey, and New York. Maine and Pennsylvania also granted pensions to state employees.
[b]Figures for Baltimore, Boston, Chicago, Detroit, Minneapolis, New York City, Pittsburgh, and San Francisco. Philadelphia also had a municipal employee pension system, but figures are not available.
SOURCE: National Industrial Conference Board (1931, p. 25), and "Care of Aged Persons in the United States" (1929, p. 3).

Proponents of social insurance were not impressed with private sector developments. They criticized private pensions for not giving workers contractual rights to future benefits, for paying benefits that were too low, and for being a financial long-shot.

It would be futile to argue that there were no problems with private pensions; there were. But the problems were not intractable and progress was being made. For example, most of the early pension plans were noncontributory and did not include explicit contract terms defining individuals' rights to future payments. Indeed, in such cases, the courts established that workers had no contractual rights to future benefits. The trend, however, was toward contributory pensions with regular vesting of contributions, and among noncontri-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

butory plans, the trend was toward explicit benefit guarantees. Also the large majority of plans adopted in the 1920s were underwritten or reinsured by private insurance companies (see Latimer 1933, pp. 44–49, 681–738). Under these newer plans, the security of future benefits was less dependent on the solvency and good intentions of the pensioning firm.

It should be noted that the rate of failure of industrial pension plans was never high. Companies apparently went to great lengths to avoid reneging on the implicit pension contract; even failing firms continued to make pension payments as a matter of course.[20] As recent research bears out, pensions have proved to be remarkably resilient over the years, with the capacity to "survive and even thrive under all kinds of economic conditions" (Ippolito 1986, p. 8).

Trade union pensions proved to be considerably less resilient than industrial pensions. Pension arrangements between unions and their members were notoriously underfunded and ill-equipped to handle economic downturns. Assessments were levied against members to finance payments to retired members, generally on a pay-as-you-go basis. Only as long as membership and wages grew—and grew fast enough to finance rising benefits—could plans such as these sustain themselves without sharp (and counterproductive) increases in assessments. As the New York Commission assessed the situation in 1929:

> The trade unions maintaining [pensions] are faced on the one hand with a desire to retain them for purposes of attracting new members and on the other hand with a growing burden of payments necessitating assessments so high as effectively to discourage entrance by young men. Their future is indeterminable, with the chances strongly toward discontinuance.[21]

Of course, had pension-plan solvency, as opposed to income redistribution, been the real concern of social insurance advocates, proposed remedies would have been far less sweeping. The government presumably could have mandated that firms insure their pension plans or meet minimum funding standards.

With respect to the adequacy of private pensions, payments were already in the upper ranges of what would be offered under the Social Security Act, and they were rising with the growth of wages and the general expansion of pension systems. There was every reason to believe that this upward trend would continue.

[20]See Latimer (1933, pp. 652–53, 677), and New York Commission on Old-Age Security (1930, p. 146).

[21]New York Commission on Old-Age Security (1930, p. 154). See also Latimer (1932).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The availability of private pensions in the early decades of this century is noteworthy given that tax incentives, often identified as a critical determinant of more recent pension growth, were largely absent. The favorable treatment of pension contributions relative to ordinary savings did not become a feature of the U.S. tax code until 1921. Even then, most people (over 80 percent) did not yet owe any federal income tax, and among those who did, the median marginal tax rate was just 4 percent. For large companies, the marginal tax rate was only 10 percent. In 1945, by contrast, when pension coverage was about to explode, most people were taxpayers and the median marginal tax rate for individuals was 23 percent, and for corporations it was 40 percent (see Ippolito 1986). With rising marginal tax rates, the favorable treatment of pension contributions would make pensions an increasingly attractive outlet for retirement savings.

Special Programs for Veterans and Public Employees

Not all workers had to await the expansion of the private pension system. Veterans—in a class of their own in terms of public support—and public employees had long enjoyed a variety of government programs providing income support in old age.

Homes, pensions, and other privileges had been available to veterans since the colonial period, and they flourished in the early decades of this century.[22] According to one estimate, in 1910, Civil War pensions provided aid to two-thirds of the native white aged population in some Northern states; as of 1913, military pensions accounted for 18 percent of federal spending.[23] Although not restricted to the elderly, the federal pension system for soldiers and veterans was the "largest pension system in America and probably the most expensive in the world," spending more than $260 million annually during the 1920s (Epstein 1938, pp. 520–30). State and local spending on relief and pensions for soldiers and veterans amounted to $80 million annually (see Bureau of Census 1926a, 1926b).

Public employee retirement systems were a more recent development. State and local retirement plans emerged in the 1890s for police, firemen, and teachers, and between 1911 and 1915 for most other public employees. The federal civil service retirement system

[22]See Glasson (1968), Studensky (1917), "Public Service Retirement Systems: U.S., Canada, and Europe" (1929), and "Public Service Retirement Systems in the United States" (1929), "Care of the Aged by the Federal Government" (1929), "The Cost of Existing Retirement Systems" (1935), Epstein (1938, pp. 520–30), Bureau of Census (1914), Achenbaum (1978).

[23]Tishler (1971, p. 89), and Achenbaum (1978, pp. 84–85).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

was adopted in 1920. In 1927, the federal government was spending $10 million on civil service pensions, and states and cities were spending $55 million on pensions for former employees.[24]

Public pensions had their own set of problems, of course, stemming from the ever-present political pressures and temptations to increase benefits while keeping taxes low. For present purposes, it is simply worth noting that for a segment of the aged population, government support was a significant part of the prevailing income support system. According to the studies commissioned in New York and Massachusetts, 10–12 percent of the aged population (70 and older) received public pensions during the late 1920s; counting pensions and relief, approximately 15 percent received some form of government assistance (see New York Commission 1930, p. 40).

Private and Public Charity

The development of new arrangements for redistributing income over time, particularly private insurance and pensions, would facilitate retirement planning and promote financial independence among the elderly in future years. But there remained the issue of those who were already old. What were the various means by which the elderly poor were being assisted?

Private Charity

The private sector had long retained the dominant role in the care of the poor of all ages, both in the realm of individual and family efforts and through more formal charitable efforts, such as those involving churches, nationality groups, and fraternal societies. Virtually all of the elderly who were not living in their own homes were living in the homes of family members (see Tishler 1971; Achenbaum 1978). The vast majority of benevolent institutions (other than almshouses) were private (see Bureau of Census 1905), and private philanthropy dwarfed government welfare spending.

As demonstrated throughout history, private charity had the capacity to respond quickly to the changing needs of the poor and to changing conceptions of the best way to provide assistance. An important innovation in this century was the private benevolent home for the aged, the forerunner of today's nursing home. Prompted,

[24]In a 1927 study of states and cities, public retirement systems were found to exist for police and firemen in almost every city, and were very common for teachers. There were statewide systems for all public employees in six states, citywide systems in nine large cities, and twenty-one states had systems covering all teachers. See "Public Service Retirement Systems: U.S., Canada, and Europe" (1929), "Public Service Retirement Systems in the United States" (1929), and Achenbaum (1978, p. 121).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

no doubt, by rising standards of living and increasing (labor market) mobility of family members, homes for the aged sprouted up throughout the United States in the second and third decades of this century. These homes offered private or semiprivate rooms, recreation, amusement, medical attention, and small burial allowances. In some cases, accommodations were made for surviving family members. According to the Bureau of Labor Statistics, there were 1,200 homes in 1929 housing about 63,000 elderly people. Most of the homes were run by religious and fraternal organizations, although trade unions and nationality groups also sponsored homes.[25]

The Public Almshouse

Standing in stark contrast to the private benevolent home was the county almshouse, which as late as 1929, was still the only form of permanent public assistance in most states.[26] Except in its capacity to provide food, shelter, and some degree of medical attention, the almshouse was decidedly not tailored to meet the needs of the elderly. Since before the days of asylums, hospitals, and reformatories, the almshouse was designed to serve all classes of "defectives" unable to care for themselves. Most almshouses were very old, lacking modern sanitation and electricity. While in some states almshouses had effectively become free hospitals for the poor and there had been some effort to segregate the elderly from others, typically inmates were not segregated on the basis of health, age, or sex.

Fortunately, reliance on the almshouse was very limited. According to the Bureau of the Census, 42,000 of the nation's elderly, or less than 1 percent, resided in almshouses in 1923. This proportion was virtually unchanged since the earlier census in 1880.[27]

All signs indicated that the almshouse was a thoroughly outdated institution in the 1920s, about to be replaced by greater reliance on cash assistance and, in time, the public hospital and the modern nursing home. The people who had once dominated the almshouse population—people under 65 who were blind or deaf, or who had epilepsy or mental disorders, for example—had been removed to new institutions specifically designed to meet their needs. The remaining almshouse population was disproportionately aged (54

[25]"Care of the Aged in the United States" (1929a, pp. 1–21), and "Care of Aged Persons in the United States" (1929).

[26]U.S. Committee on Economic Security, cited in Stevens (1970, p. 20), and Armstrong (1932, pp. 394–97). For more on almshouses, see Bureau of Census, *Paupers in Almshouses*, 1904 and 1923 editions, "The Cost of American Almshouses" (1925), "Cost and Conduct of American Almshouses" (1927), and Bureau of Census (1914).

[27]Bureau of Census, *Paupers in Almshouses: 1923*.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

percent in 1923 as compared to 26 percent in 1880). The fact that many counties had been left with institutions not designed for what had become their primary use naturally focused attention on new ways to care for the elderly poor.

Outdoor Relief

Throughout the years, local governments supplemented institutional care with some outdoor relief, whether in the form of payments for groceries or medical services, for example, or outright cash. Although sharply curtailed in the late 1800s, outdoor relief was reviving in the early part of this century. Between 1915 and 1928, outdoor relief by state and local governments grew at twice the rate of overall government spending, and it rose as a share of charity spending as well.[28] It was still not the rule, however. In the late 1920s, just 9 percent of state charity spending and 36 percent of local charity spending was in the form of outdoor relief (see Bureau of Census 1926a, 1926b). Some major cities, such as San Francisco and New York, were legally prohibited from dispensing outdoor relief.

The role of government was changing, though. Beginning in this century, categorical assistance programs emerged, making welfare payments available to all persons meeting certain eligibility criteria. The first programs, all at the state and local level, were for mothers of dependent children, but old-age assistance followed soon thereafter. Beginning in 1914 and continuing through 1929, old-age assistance programs were authorized in Arizona, Montana, Nevada, Pennsylvania, Wisconsin, Kentucky, Washington, Colorado, Maryland, California, Utah, Minnesota, and Wyoming. Designed to provide a steady, subsistence level of income for the elderly poor who were without family, these programs typically provided for a small monthly payment (not to exceed $25–$30) to people 70 years of age and older with very low incomes (below $300 annually) and assets (less than $3,000).[29]

The new old-age assistance programs did more to signal a change in the role of the government than they did to actually improve public support for the elderly poor. The adoption and implementation of old-age assistance programs were fraught with constitutional, financial, and political obstacles. Laws were vetoed, found unconstitu-

[28]See Bureau of Census (1926a, 1926b); also Weaver (1982, pp. 22–23), Clarke (1940), Warner (1908), Warner et al. (1930), Trattner (1974), and Abbott (1966).

[29]On the trend toward old-age pensions, see Douglas (1939, pp. 5–10), Epstein (1938, pp. 532–50), National Industrial Conference Board (1931, pp. 44–65), "Old-Age Pensions and Relief" (1927, 1929), and New York Commission on Old-Age Security (1930, pp. 220–70).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

tional, repealed, and amended. Prior to the Depression, the rate of county participation and the number of pensioners remained very low. Under the new laws, the localities were empowered to collect and dispense public funds for the care of the elderly poor; they were not required to set up assistance programs and generally were not subsidized to do so. Nevertheless, a structure was in place to handle the cash needs of the elderly, a structure that would be put to the test during the Depression.

Old-age assistance was an idea whose time had come. Social reformers had gained the support of the fraternal societies and trade unions, two long-time opponents of government action, in the push for old-age assistance. Most of the states investigating the problems of the aged concluded that old-age assistance was preferable to prevailing public arrangements for the poor.

On the Eve of the Great Depression

As the 1920s drew to a close, the family and voluntary associations remained the bulwark of support for the needy of all ages. Yet, political sentiments were crystallizing around proposals for direct cash assistance for the elderly poor. Old-age assistance laws had been passed by a quarter of the states and legislation was under consideration in most others. Very likely, the trend toward cash assistance provided by state and local governments would have continued even in the absence of the Depression.

Proposals for compulsory social insurance, by contrast, were unable to generate any popular support. By and large, the elderly who were poor tended to have been poor or to have had low incomes as younger people; workers who had sufficient resources to save for retirement found outlets for their savings in a well-developed market for life insurance, a developing market for private pensions, and a variety of other financial arrangements. The available evidence suggests that private financial institutions, in combination with public and private assistance for the poor, accommodated the retirement income needs of the elderly. As those needs changed, private institutions were responding and the basis for compulsory insurance was weakening.

References

Abbott, Edith. *Public Assistance: American Principles and Policies*. 1940: reissued in 2 vols. New York: Russell and Russell, 1966.

Achenbaum, Andrew. *Old Age in the New Land*. New York: Twentieth Century Fund, 1978.

Armstrong, Barbara. *Insuring the Essentials: Minimum Wage Plus Social Insurance—A Living Wage Program*. New York: Macmillan, 1932.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Bureau of Census. *Benevolent Institutions: 1904.* Washington, D.C.: Government Printing Office, 1905.
Bureau of Census. *Summary of State Laws Relating to the Dependent Classes: 1913.* Washington, D.C.: Government Printing Office, 1914.
Bureau of Census. *Financial Statistics of Cities Having a Population Over 30,000.* Washington, D.C.: Government Printing office, 1926a.
Bureau of Census. *Financial Statistics of States: 1925.* Washington, D.C.: Government Printing Office, 1926b.
Bureau of Census. *Historical Statistics of the United States: Colonial Times to 1970.* Bicentennial ed. 2 vols. Washington, D.C.: Government Printing Office, 1975.
Bureau of Census. *Paupers in Almshouses.* Washington, D.C.: Government Printing Office, various issues.
California State Department of Social Welfare. *Old Age Dependency: A Study of the Care Given to the Needy Aged in California.* Sacramento: California State Printing Office, 1929.
"Care of Aged Persons in the United States." *Bulletin of the U.S. Bureau of Labor Statistics* no. 489 (October 1929): 3–193.
"Care of the Aged by the Federal Government." *Bulletin of the U.S. Bureau of Labor Statistics* no. 489 (October 1929): 63–64.
"Care of the Aged in the United States." *Monthly Labor Review* 28, no. 3 (March 1929a): 1–21, 34.
"Care of the Aged in the United States." *Monthly Labor Review* 29, no. 1 (July 1929b): 1–30.
"Care of the Aged." *Monthly Labor Review* 30, no. 4 (April 1930): 9–13.
Clarke, Helen I. *Social Legislation: American Laws Dealing with Family, Child and Dependent.* New York: D. Appleton-Century, 1940.
"Cost and Conduct of American Almshouses." *Bulletin of the U.S. Bureau of Labor Statistics* no. 439 (June 1927): 445–54.
"The Cost of American Almshouses." *Bulletin of the U.S. Bureau of Labor Statistics* no. 386 (June 1925): 1–51.
"The Cost of Existing Retirement Systems." *Congressional Digest* 15 (March 1935): 73.
Darby, Michael. *The Effects of Social Security on Income and the Capital Stock.* Washington, D.C.: American Enterprise Institute, 1979.
Davis, M. E. *Industrial Life Insurance in the United States.* New York: McGraw-Hill, 1944.
Douglas, Paul. *Social Security in the United States.* New York: McGraw-Hill, 1939.
Epstein, Abraham. *Insecurity: A Challenge to America.* New York: Random House, 1938.
"Extent and Distribution of Old Age Dependency in the United States." *Monthly Labor Review* 38, no. 1 (January 1934): 1–17.
Glasson, William H. *History of Military Pension Legislation in the United States.* 1900: reissued. New York: AMS Press, 1968.
Goldsmith, R. W. *A Study of Saving in the United States.* 2 vols. New York: Greenwood Press, 1969.
Gompers, Samuel. "Not Even Compulsory Benevolence will Do." *The American Federalist* 23 (1917): 198.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

"Handbook of Labor Statistics: 1924–1926." *Bulletin of the U.S. Bureau of Labor Statistics* no. 439 (June 1927): 431–36, 445–54.
"Handbook of Labor Statistics: 1929 Edition." *Bulletin of the U.S. Bureau of Labor Statistics* no. 491 (August 1929): 529–32, 542–49.
Henderson, C. R. *Industrial Insurance in the United States.* Chicago: University of Chicago Press, 1909.
Ippolito, Richard A. *Pensions, Economics, and Public Policy.* Homewood, Ill.: Dow Jones-Irwin, 1986.
Johnson, Julia. *The Reference Shelf: Old Age Pensions.* Vol. 10, no. 3. New York: H. W. Wilson, 1935.
Keeler, M. *The Life Insurance Enterprise, 1885–1910.* Cambridge, Mass.: Harvard University Press, 1963.
Landis, A. "Life Insurance by Fraternal Orders." *Annals of the American Academy of Political and Social Science* 24 (1904): 475–88.
Latimer, Murray W. *Relations of Maximum Hiring Ages to the Age Distribution of Employees.* New York: American Management Association, 1930.
Latimer, Murray H. *Trade Union Pension Systems.* New York: Industrial Relations Counselors, Inc., 1932.
Latimer, Murray H. *Industrial Pension Systems in the U.S. and Canada.* New York: Industrial Relations Counselors, Inc., 1933.
Lubove, Roy. *The Struggle for Social Security: 1900–1935.* Cambridge, Mass.: Harvard University Press, 1968.
MacLean, J. B. *Life Insurance.* New York: McGraw-Hill, 1935.
McGill, D. *Life Insurance.* Homewood, Ill.: Richard D. Irwin Press, 1967.
Mehr, R. L., and Cammack, E. *Principles of Insurance.* Homewood, Ill.: Richard D. Irwin Press, 1976.
Munnell, Alicia H. *The Effect of Social Security on Private Saving.* Cambridge, Mass.: Ballinger, 1974.
National Industrial Conference Board. *The Support of the Aged: A Review of Conditions and Proposals.* New York: National Industrial Board, 1931.
New York Commission on Old-Age Security. *Old-Age Security.* Albany: J. B. Lyons and Co., 1930.
Nichols, Walter. "Fraternal Insurance in the United States: Its Origin, Development, Character and Existing Status." *Annals of the American Academy of Political and Social Science* 70 (1917): 109–22.
"Old-Age Pensions and Relief." *Bulletin of the U.S. Bureau of Labor Statistics* no. 439 (June 1927): 431–36.
"Old-Age Pensions and Relief." *Bulletin of the U.S. Bureau of Labor Statistics* no. 491 (August 1929): 529–32.
O'Neill, Thomas P., Jr. "My Own View of Our Country." *Vital Speeches of the Day* 51, no. 6 (1 June 1985): 482–85.
"Public Service Retirement Systems in the United States." *Bulletin of the U.S. Bureau of Labor Statistics* no. 491 (August 1929): 542–49.
"Public Service Retirement Systems: U.S., Canada, and Europe." *Bulletin of the U.S. Bureau of Labor Statistics* no. 477 (January 1929): 1–170.
Rubinow, Issac. *Social Insurance.* New York: Henry Holt, 1916.
Rubinow, Issac. *The Quest for Security.* New York: Henry Holt, 1932.
Social Security Administration. *Social Security Bulletin: Annual Statistical Supplement, 1983.* Washington, D.C.: Government Printing Office, 1985.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Stalson, J. O. *Marketing Life Insurance: Its History in America.* Cambridge, Mass.: Harvard University Press, 1942.

"Status of Old Age Pension Legislation in the United States." *Monthly Labor Review* 29, no. 1 (1929): 21–28.

Stevens, Robert B., ed. *Statutory History of the United States: Income Security.* New York: Chelsea House, 1970.

Studensky, Paul. *The Pension Problem and the Philosophy of Contributions.* New York: Pension Publishing, 1917.

Tishler, Hace. *Self Reliance and Social Security: 1870–1917.* Port Washington, Wisc.: Kennikat Press, 1971.

Trattner, Walter. *From Poor Law to Welfare State: A History of Social Welfare in America.* New York: The Free Press, 1974.

U.S. Committee on Economic Security. *Supplement to the Report of the Committee on Economic Security.* Hearings before the Committee on Finance on S.1130, U.S. Senate, 74th Cong., 1st sess, 1934.

U.S. Committee on Economic Security. *Report to the President.* Washington, D.C.: Government Printing Office, 1934.

U.S. Social Security Board. *Trends in Public Assistance: 1933–1939.* Washington, D.C.: Government Printing Office, 1940.

Warner, Amos. *American Charities.* New York: T. Y. Crowell, 1908.

Warner, Amos; Queen, S.; and Harper, E. *American Charities and Social Work.* New York: T. Y. Crowell, 1930.

Weaver, Carolyn L. *Crisis in Social Security: Economic and Political Origins.* Durham: Duke University Press, 1982.

Weaver, Carolyn L. "On the Lack of Compulsory Old-Age Insurance Prior to the Great Depression: Insights from Economic Theories of Government." *Explorations in Economic History* 20 (1983): 294–328.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE POLITICAL ECONOMY OF ACID RAIN

Richard Meyer and Bruce Yandle

Introduction

Although the relationship is certainly controversial, acid rain is a story about sulfur dioxide (SO_2).[1] The story begins with fossil fuel. Combustion in fossil fuel-fired power plants and chemical processes in other industries generate vast quantities of oxides of oxygen that generally are emitted to the environment as waste. In the case of sulfur dioxide, emissions may be dispersed as far as several hundred miles from the source and along the way become dissolved in atmospheric moisture, forming acid, which is deposited downwind as precipitation (Record 1982). The use of high sulfur coal to produce electricity is not simply a matter of unconstrained choice, however. Federal regulation has prodded producers away from the use of low sulfur coal and natural gas, which would produce little or no SO_2 (Gordon 1978, pp. 44–45). As in many other cases, the demand for one regulation has led to the demand for another.

Highly valued production of electricity in coal-fired utilities in the Midwest begins a process that leads to the deposition of acid rain on valuable resources in the Northeast. At its simplest theoretical level, the problem is one of property rights. There are no fee simple rights to environmental use that can be enforced and traded in markets. Because of this, tension between the Midwest and the Northeast forms the elements of a classic two-party externality struggle. As

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.

The authors are, respectively, Associate Director of the Robert Muldrow Cooper Library and Alumni Professor of Economics at Clemson University. They wish to thank E. I. DuPont de Nemours and Company for supporting their environmental research.

[1]The history of the problem is discussed by Cowling (1982). We recognize that SO_2 is not the only source of acid rain and that debate about the linkages between emissions from industrial sources and acid precipitation still rages. Nonetheless, we have focused our research on the elements of the political debate that have formed around proposals for legislation to control SO_2 emissions. That legislation focuses on stationary emission sources, especially coal-fired generators of electricity.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

indicated by Coase (1960), when property rights are not defined and enforced, or when transactions costs are high, the contentious parties can call on government to deal with the issue. Sometimes the gains from trade that might be achieved through a market for rights to environmental use can be converted and used to influence the political mechanism (Buchanan and Stubblebine 1962).

Coase's prediction about political remedies is better remembered than his major insight about the basic problem itself. Coase reminds us that external effects are reciprocal. There would be no acid rain damage were it not for economic activity that values environmental use. Conversely, there would be no discharge of waste, were it not for economic activity that values environmental use. In theory, both parties are identically situated, since both would like to have unencumbered use of the environment at zero price. In spite of Coase's insight about the reciprocal nature of externalities such as pollution, the focus of the acid rain problem is on the producers and users of electricity and the owners of coal deposits and their employees—not on the owners of buildings, property tax collectors, fishermen, recreationists, forest product producers, and a diverse public that desires economic gain by placing restrictions on other environmental users.

Electricity production from burning coal is an important segment of the economies of Illinois, Indiana, Kentucky, Michigan, Missouri, Ohio, Pennsylvania, Tennessee, West Virginia, and Wisconsin, the region that produces the lion's share of SO_2. Forest products, farming, sport fishing, and other recreational activities are important to the economic activity of Connecticut, Maine, Massachusetts, New Hampshire, New York, Rhode Island, and Vermont, receivers of unwanted SO_2. The resulting regional conflict has led to appeals to Congress from the receivers of acid rain. For almost a decade, Congress has wrestled with the problem, yet final legislation has not been passed.[2] Forces of supply and demand that might interact in a market for environmental property rights are still being applied to members of Congress. However, while almost 20 bills have been discussed in congressional committees since 1980, only two have received a committee vote.

A careful identification of appropriable rents that might be created or protected by the property rights formed by acid rain legislation

[2]For a summary discussion of the acid rain problem and efforts to resolve it, see Congressional Research Service (1984), U.S. General Accounting Office (1981), U.S. Office of Technology Assessment (1984), Record (1982), and Wetstone and Foster (1983). Crandall (1984) discusses legislative controversies surrounding acid rain control and reports the results of empirical work conducted to explain the design of bills we later analyze. He does not attempt to predict voting behavior, however.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

helps to determine the positions taken by economic agents who seek to influence the legislative process. Upon making that determination, predictions of voting behavior can be made and tested. This paper seeks to explain the outcome of committee votes on legislative proposals and why Congress has repeatedly failed to pass acid rain legislation, even though the Clean Air Act of 1970 requires reauthorization and the acid rain issue has national and international implications (Brown 1981). Since one of the committee votes analyzed here occurred in the House and the other in the Senate, we can also identify differences in political behavior that might be explained by economic forces.

The remainder of the paper is organized as follows. First, we provide additional background to the acid rain controversy, discuss various legislative proposals, and address the potential wealth redistribution and cost considerations associated with proposed legislation.[3] Next, we develop a model that explains voting behavior and report the results of several estimation procedures that analyze a vote in each chamber of the 98th Congress. This is followed by some concluding remarks.

The Problem and Its Distributional Consequences

Table 1 reports 1980 data on SO_2 emissions by source category for a 31-state region bordering and east of the Mississippi River and collective data for the remaining states. Most legislative proposals addressing SO_2 reductions have focused on the 31-state region where the heavy production of SO_2 from Midwest states is apparent in the table. The 10 Midwest states mentioned above, which are the largest emitters, produced 10.3 million tons of the 15.7 million tons of SO_2 emitted by all electric utilities in the United States in 1980.

Because of the nature of predominant atmospheric air currents, releases from the Midwest are precipitated in the Northeast, where soil buffering capacity is low and biological effects are substantial.[4] It is of great interest, however, that the receiving states also are producers of SO_2, which is swept away to sea or to Canada. In fact, our calculations of the tons of SO_2 per million kilowatt hours of electricity produced in the 31-state region rank Massachusetts in first

[3]The work to be reported is developed in the tradition of research on regulation and legislation developed by Stigler (1971), Peltzman (1976), Kau and Rubin (1979), Kalt (1983), and Kalt and Zupan (1984).

[4]We recognize the controversial nature of conclusions drawn on the nature of the linkage between SO_2 emissions and acid rain. That and other illustrative examples of damage are discussed in U.S. Department of the Interior (1983a, 1983b).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

TABLE 1

ESTIMATED 1980 SULFUR DIOXIDE EMISSIONS
(THOUSANDS OF TONS)

State Emissions	Total Emissions	Utility Combustion	Nonutility Combustion	Process Emissions	Other
31-State Region:					
Alabama	759	543	86	95	35
Arkansas	102	27	32	29	14
Connecticut	72	32	35	0	5
Delaware	109	52	26	25	6
District of Columbia	15	5	8	0	2
Florida	1,095	726	97	159	113
Georgia	840	737	44	14	45
Illinois	1,471	1,126	188	119	38
Indiana	2,008	1,540	290	151	27
Iowa	329	231	57	27	13
Kentucky	1,121	1,008	66	29	18
Louisiana	304	25	76	153	50
Maine	95	16	65	4	10
Maryland	338	223	56	42	17
Massachusetts	344	275	58	1	11
Michigan	907	565	154	152	35
Minnesota	260	177	44	18	22
Mississippi	285	129	48	75	32
Missouri	1,301	1,141	55	81	25
New Hampshire	93	80	10	0	2
New Jersey	279	110	75	42	52
New York	944	480	335	71	59
North Carolina	602	435	116	23	28
Ohio	2,647	2,172	311	118	46
Pennsylvania	2,022	1,466	254	239	63
Rhode Island	15	5	8	0	2
South Carolina	326	213	84	13	16
Tennessee	1,077	934	83	27	33
Vermont	7	1	5	0	1
Virginia	361	164	142	14	41
West Virginia	1,088	944	84	43	16
Wisconsin	637	486	107	5	40
Other 19 States	4,708	1,306	404	2,529	467
U.S. Total	26,557	17,373	3,504	4,296	1,385
Percent of Total	100	65	13	16	5

SOURCE: U.S. Office of Technology Assessment (1984).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

place, Vermont second, followed by Florida, New York, and New Hampshire.[5] Four of the five are in the region that expresses the greatest concern about acid rain and environmental quality (Pasztor 1984). The same calculations show that the states targeted for control already have the cleanest output on a per-kilowatt-hour basis.

These calculations suggest that the problem has little to do with a pure environmental ethic but much to do with economic costs. The major emitters of SO_2 are simply exceptionally large producers of electricity. The fact that their output is much cleaner per unit than that of the receiving states indicates that the marginal cost of control likely will be higher for them. It is generally less costly to remove large particles from an environmental discharge than smaller ones.

While there are several ways to reduce the effects of acid rain, the principal methods in use and being discussed are coal washing, flue gas desulfurization scrubbing, and switching to low sulfur coal. The first has the advantage of low capital costs, though it reduces sulfur content by no more than 40 percent. Scrubbing flue gas reduces sulfur oxides very effectively, but has high capital costs and produces large amounts of solid waste. Fuel switching is less expensive than scrubbing but disrupts coal workers and owners of coal deposits in the East. Indeed, the current regulations requiring scrubbers on new coal-burning generators spawned by the 1977 amendments to the 1970 Clean Air Act resulted from successful efforts to protect coal interests in the East (Ackerman and Hassler 1981; White 1981).

Since 1980, seven pieces of major legislation requiring SO_2 reductions have been introduced in the Senate and at least 10 in the House (see Table 2). Most of the proposals have focused on SO_2 emissions in the Midwest and the 31-state region. There are four common proposals found in all the bills:

1. Reductions of SO_2 emissions across all coal-fired plants equal to the difference between an EPA standard and current emission levels, for a total reduction of either 8, 10, or 12 million tons annually.
2. Reductions of SO_2 for all coal-fired plants in the 10-state region with the heaviest emitters; no specified technology for achieving reductions, but with constraints on fuel switching.
3. Reductions of SO_2 for the top 50 emitting plants in the United States, all in the 31-state region; scrubbers or other capital-intensive technology required; reductions across remaining plants to bring the total to 10 million tons annually.

[5]The calculations were based on data on emissions and electricity production from U.S. Office of Technology Assessment (1983).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

TABLE 2

ACID RAIN LEGISLATIVE PROPOSALS, 1981–86

Year	Item	Sponsor	Disposition
1981	S723	Tower (R–Tex.)	Referred to committee
1982	HR5555	Waxman (D–Calif.)	Referred to committee, washed out
1983	HR132	Gregg (R–N.H.)	Marked up with HR5314
	HR2794	St. Germain (D–R.I.)	Marked up with HR5314
	HR3400	Sikorski (D–Minn.)	Marked up with HR5314
	HR5314	Waxman Mitchell (D-Maine)	Failed committee vote 10 to 9
	S145		Marked up with S768
	S768	Stafford (R–Vt.)	Reported May 3, 1984
1985	HR967	Florio (D–N.J.)	Referred to committee
	HR1030	Conte (R–Mass.)	Referred to committee
	HR1414	Green (R–N.Y.)	Referred to committee
	HR2679	Udall (D–Ariz.), Cheney (R–Wyo.)	Referred to committee
	HR2918	Rinaldo (R–N.J.)	Referred to committee
	S52	Stafford	Referred to committee
	S283	Mitchell	Referred to committee
	S503	Proxmire (D–Wis.)	Referred to committee
1986	HR4567	Waxman	Markup due
	S2203	Stafford	Referred to committee

NOTE: Table 2 includes the major items of legislation introduced into the House and Senate since 1980 to amend the Clean Air Act of 1970 with requirements for acid rain precursor emissions reductions.
SOURCE: Congressional Research Service (1980–86).

4. Taxes to be placed on consumers of electricity to fund the cost of emission control capital.

Some bills establish a superfund to be collected from a per-kilowatt-hour tax imposed on all users of coal-generated electricity, often focusing on consumers in the 31-state region. Others spread the tax across the entire country, and still others require the electrical utilities themselves to fund the costs.

The predicted costs of the various programs also vary, depending on SO_2 reduction amounts, their timing, and the extent to which individual polluters will be allowed to minimize their control costs.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Published annual cost estimates range from $2.7 billion to $7 billion (in 1982 dollars).[6] An extensive plant-specific cost study, which considered 24 firms that account for 44 percent of the emissions to be reduced, indicates annual costs of $5 billion and cumulative capital costs of $15 billion (National Economic Research Associates 1983). When these additional costs are added to the current $2.4 billion annual expenditure on SO_2 control, the new annual total ranges from $5 to $10 billion for control of one major pollutant.

An analysis of one 1983 House proposal, HR3400 (later marked up with HR5314, analyzed below), gives an indication of the legislation's effect on consumer electricity bills (U.S. Office of Technology Assessment 1983). In an initial phase, all consumers of coal-fired electricity would pay a tax that would fund 90 percent of the capital costs for the 50 largest emitters. During a second phase, there would be a combination of the tax and a price increase. In the last phase, when heavy capital expenditures are completed, consumers served by particular firms will bear emission control costs. Across these three phases, depending on the state involved, consumer electricity bills would increase by as much as 12.9 percent (Indiana) to as little as zero (Arizona). Without the tax and superfund, electricity rates would rise by as much as 19 percent (Indiana). Consumer in several other high emission states would see their electricity bills rise by 12 to 19 percent.

The different distributional effects of the various proposals are obvious. In no case will the beneficiaries of acid rain control be required to pay directly for their gains. At most, consumers in those states will pay a surtax on their electricity bills. It is also rare that public utilities would be required to pass the full cost of the mandated controls to their consumers and investors. The bills generally have the political attraction of providing concentrated benefits to a few with costs spread across many.

Perhaps because of the magnitude of the costs and the competing methods for funding them, only two bills—S768 and HR5314—were actually voted on in committee, and none has been introduced to the floor for a vote (see Table 3). Neither bill allowed fuel switching, and both protected interests in the East. The House version mandated the use of scrubbers, which relates to the continued use of high sulfur Eastern coal, and the Senate version allowed for coal washing, which

[6]A survey of acid rain control cost studies was prepared by Gordon Brady for a conference on the relative merits of emission trading sponsored by the Council on Environmental Quality and the U.S. Department of the Interior, 16–17 July 1984. The data reported here are drawn from Brady (1984).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

TABLE 3

COMPARISON OF TWO BILLS TO REDUCE ACID RAIN

Element of Bill	S768	HR5314
Reduction goal	10 million tons	10 million tons
Allocated per state?	Yes, by formula	Yes, by formula
Emission restriction	1.2 lbs/mil Btu	1.2 lbs/mil Btu
Deadline goal	1994	1993
Abatement area	31 state area	31 state area
Abatement method	Any except fuel switching	Scrubbers
Funding	Study proposed	Superfund
Revenue generation	Study proposed	1 mill per kilowatt hour
Targeted emitters	None targeted	50 biggest utility emitters
Trading allowed	Yes, as offsets within region	Yes, as offsets between states
New sources	Must be offset	Must be offset

also protects Eastern coal. Both bills allowed some trading of emission reductions among polluters; that is, those firms that can control emissions at a lower cost would be allowed to sell additional units of reductions to firms that have higher control costs. S768 did not target specific emitters for control, nor did it propose a method for funding and revenue generation. Fundamentally, the two bills aimed to reduce SO_2 emissions from the 1980 level of 24 million tons to 14 million tons. Given an expected linear relationship between emissions and acid rain deposition, both bills anticipated an overall reduction of acid rain by 40 percent.

While the substance of the two bills is very similar, the committee voting patterns clearly are not. In the case of S768, the vote was 16 to 2 in favor, with no abstentions. The proposal for HR5314 failed in committee with a recorded vote of 10 to 9 and no abstentions.[7] Overall voting patterns reflect the distribution of committee members among states with high SO_2 emissions, receivers of damaging acid rain, and

[7]Details on S768 and HR5314 are covered in Davis (1984), O'Donnel (1983), *Major Legislation of the Congress* (1984), and "Environmental Protection Agency Programs: Congressional Activities" (1984).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

states that are not directly involved in the controversy. These patterns relate to constituency group pressures or efforts to gain or maintain wealth through the political process.

Our discussion of the acid rain controversy and proposed legislation suggests that there are three groups of economic agents that interact in forming a demand for political action. First, there are the producers of SO_2, primarily regulated monopolies in their respective states. These firms may demand national legislation to gain beneficial results in their requests for rate increases, as well as for subsidies of control costs they would incur in building plants under current regulations. Given their regulated status, however, the electrical utilities have little to gain from the legislation as proposed.

The second group includes environmental groups, owners of land, buildings, and other improvements, state and local governments whose property tax revenues are affected, and other organized groups that represent receivers of acid rain. These less concentrated groups, relative to electrical utilities, represent votes and funds for campaigns. They obviously will provide more support if benefits are provided to them at low cost, and they have the most to gain in terms of enhanced rents from the legislation as proposed.

The third force implied in the discussion comes from labor employed in mining high sulfur coal, organized labor in the power industry, and the owners of capital and resources in the coal industry (White 1981, pp. 72–77). Organized labor and owners of assets in the coal industry have an obvious interest in legislation that could sharply reduce or even eliminate the rents being earned on the specialized factors in their industry. Furthermore, it is in the interest of labor in the generating industry to have capital intensive regulations that reduce the relative cost of labor and increase demand for their services (Miller 1984). Labor is highly organized, has been sensitive to past efforts to control SO_2 emissions, and represents a large voting group. It is highly doubtful that they simply desire SO_2 reductions, since they are not receivers of acid rain. They are arguably more concerned about fuel switching and higher priced electricity that reduces demand for coal. At best, acid rain legislation prospects are negative for this group.

The eventual supply of legislation will come when the number of constituent votes and amount of campaign contributions from environmentalists and receivers of acid rain are large enough to offset the losses of political support from SO_2 producers and coal interests.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Of course, any steps to mitigate the costs imposed on the latter groups strengthen the environmentalists' demands.

Empirical Analysis of the Votes

In a study closely related to our work, Robert Crandall (1984) developed a political economy analysis of the 1983 congressional effort to pass acid rain legislation. His model estimated the relationship between SO_2 reductions included in legislation for each state and ambient air quality, distance from the alleged receivers of acid rain, and the number of legislators from each state who served on the relevant congressional committees. Unlike our research, which focuses on appropriable rents and who gains from them, Crandall's results supported the hypothesis that the legislation was designed to distribute the burden of control costs. He found no relationship between severe SO_2 problems in a local area and the amount of emission reductions targeted for that area, a finding in harmony with our theory.

Several other studies have analyzed the redistribution of costs and voting behavior associated with federal pollution legislation.[8] An overall assessment of these works indicates that political and ideological variables tend to give way in importance to economic ones when the stakes are high. The economic impact of acid rain legislation, like that for the control of surface mining, is extremely high (Kalt 1983). We argue that ideological variables will play a minor role in our analysis and have tested that argument empirically.

Committee member votes on S768 and HR5314 reflect the economic interests of constituents, and may reflect political interests insofar as party guidance and logrolling influence voter behavior. Since we analyze votes in both houses of Congress, we will estimate the effects of party and house, which will allow us to draw inferences regarding the degree to which party direction matters.

Our discussion of the efforts to pass acid rain legislation and the two single items that have been voted on in committee offers predictions of political behavior based on property-rights'-driven appropriable rents. Those legislators representing states in which coal mining for electricity is important are predicted to vote negatively, because a tax on electricity or a cost-induced price increase will have negative effects on rents earned in coal mining. These are mostly the same states that emit large amounts of SO_2. Representatives of states that receive large amounts of acid rain are expected to favor the legislation. There are clearly rents to be gained from the improve-

[8]See Kau and Rubin (1979), Kalt (1983), Kalt and Zupan (1984), Peltzman (1984), Crandall (1984), Silberberg and Nelson (1985), and Frendreis and Waterman (1985).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ments of natural resources and physical structures in those states, and little cost is imposed in exchange for those rents.

Because we were analyzing a yes-no dependent variable, we sought to develop a maximum likelihood logit model assigning values of one to "yes" votes and zero to "no" votes. We tested the specification of explanatory variables using an ordinary least squares regression model, recognizing that the results would be biased but nonetheless similar to those of the logit. The general model for a pooled sample that includes both the House and the Senate vote is written:

$$\text{VOTE} = \text{F(PARTY, SENATE, SO2PRCNT, FPROD, LCVRATE, INCGRWTH, NATLANDS, AIRPOL, WQUAL, REGION)},$$

where the definitions and predictions for each variable are given in Table 4. All variables other than the three indicator variables are for states represented by the congressional committee members. Some of the entries in Table 4 indicate that we make no firm, a priori predictions for coefficients. We do expect PARTY to be positively signed when analyzing the House vote, because the majority party was Democrat in that chamber. We cannot make predictions, however, for the combined sample.

We predict a positive coefficient for FPROD on the basis of cost imposed by acid rain on that industry. Following Crandall (1983), we predict LCVRATE will be positive, assuming that ideology not accounted for by other variables remains unexplained. The prediction for INCGRWTH is based on work by Yandle (1984), where a vote on an SO_2-related amendment was explained partly by using growth in value added in manufacturing, which was negatively signed. The argument for this effect states that rapidly growing regions, which generally have lower levels of income, resist regulations that may impede growth.

The next three variables are also drawn from Crandall (1983). The coefficient on NATLANDS is shown as negative in Table 4, but there are two arguments regarding its effect. A public interest argument states that congressional managers of the public trust will vote to preserve the value of federal lands, assuming acid rain damages forests. The predicted negative sign is based on the obverse effect. Large holdings of government-owned land imply relatively small holdings of privately owned land. Private gains are generated when

[9]Data for the variables are from the following sources: Davis (1984), O'Donnel (1983), Congressional Research Service ([June 1984] 1980–86), "Environmental Protection Agency Programs: Congressional Activities" (1984), U.S. Office of Technology Assessment (1984), U.S. Bureau of Labor Statistics (1982), and Crandall (1983).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

TABLE 4

ACID RAIN VOTING BEHAVIOR MODEL

Explanatory Variable	Description	Sign on Coefficient
PARTY	An indicator variable equal to one for Democrat, and zero otherwise.	No prediction
SENATE	An indicator variable equal to one for Senate votes, and zero otherwise.	No prediction
SO2PRCNT	The total metric tons of SO_2 released by electrical utilities in each state as a percent of total national loadings.	Negative
FPROD	The share of state labor employed in forest products industry activities.	Positive
LCVRATE	The League of Conservation Voters rating, where a higher value is presumed to reflect greater sensitivity to environmental issues.	Positive
INCGRWTH	The ratio of state income in 1979 and 1959	Negative
NATLANDS	The percentage of state land owned by the federal government.	Negative
AIRPOL	The percentage of state population living in counties where the SO_2 level exceeds the national standard.	Positive
WQUAL	The average water quality of state streams, where a higher value reflects higher pollution.	Positive
REGION	An indicator variable to separate 31 states in the control region from others, where a control state is set equal to one.	No prediction

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

private land is protected from acid rain. We chose the special interest argument, not the public interest one. Both arguments assume legislators vote to protect an interest. In the special interest case, however, the resulting rents are appropriable.

The next two variables, AIRPOL and WQUAL, adjust for differences in environmental quality across the states represented by the voters in the two samples. AIRPOL measures the level of human exposure to higher levels of SO_2 emissions, and we predict its coefficient will be positive. This assumes that politicians are sensitive to public health, all else equal. We recognize, however, that it would be difficult to appropriate gains from long-term improvements in human health. We also predict the coefficient on WQUAL to be positive. Since that variable accounts for the quality of fishing waters, we assume the gains from improvements could be more readily captured by special interests than in the case of air quality. Finally, the dummy variable REGION is included to adjust for disinterested legislators, to the extent there are any. The level of disinterest, we argue, will rise for those outside the 31-state control region. We note also that NATLANDS tends to identify Western states, since those states have a larger share of public lands. A significant coefficient on REGION implies a partial effect not captured by NATLANDS.

The results for the OLS regressions are reported in Table 5, which includes an analysis of the merged sample along with separate analyses for House and Senate votes. As indicated, the effect of SO2PRCNT is negative and significant in both the merged vote and House analyses, which indirectly supports the argument that legislators will vote on the basis of special interests. The dummy for Senate is positive, which we interpret to suggest that the Senate followed its leadership. PARTY is positive and significant in the combined test, and the results for the House analysis tell us why: Party membership matters in the House, and the effect is transmitted to the combined sample analysis.

FPROD approaches significance in the merged vote equation, and it becomes significant in the Senate equation. In this case, we have a perverse outcome, one that suggests forest products interests oppose reductions in acid rain. Thinking that the variable used was too inclusive, in that it included pulp and paper mills that are SO_2 emitters, we narrowed the model by limiting FPROD to labor employed in the pulp and paper industry, and modified SO2PRCNT to emissions other than those from electrical generators. Our results were virtually unchanged, although the coefficient on the new FPROD variable had a slightly lower level of significance. Apparently, con-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

TABLE 5

OLS REGRESSION RESULTS FOR MERGED AND SEPARATE VOTES ON S768 AND HR5314

Variable	Coefficients for Merged Votes[a]	House	Senate
SO2PRCNT	-0.0656 (-2.224)[c]	-0.0742 (-1.968)[d]	0.0312 (0.573)
SENATE	0.4005 (2.920)[b]		
PARTY	0.3432 (2.409)[c]	0.7335 (3.518)[b]	-0.1146 (-0.915)
FPROD	-0.0543 (-1.107)	0.0192 (0.224)	-0.0739 (-1.983)[d]
LCVRATE	-0.0002 (-0.054)	0.0024 (0.292)	0.0030 (0.877)
INCGRWTH	-0.2522 (-1.082)	-0.3977 (-1.011)	-0.1236 (-0.612)
NATLANDS	-0.9732 (-1.476)	-0.1624 (-0.132)	-2.3557 (-4.286)[b]
AIRPOL	0.0088 (1.518)	0.0049 (0.544)	0.0059 (1.080)
WQUAL	0.0281 (1.447)	-0.0296 (-0.747)	0.0582 (3.606)[b]
REGION	-0.1597 (-0.694)	-0.2609 (-0.718)	-0.4544 (-2.035)[d]
R^2	0.5358	0.7343	0.7838
Adj R^2	0.3572	0.4687	0.5405
F Statistic	3.001	2.764	3.222
N	37	19	18

[a]Values of *t* statistics in parentheses.
[b]Significant at the 1 percent level for a two-tailed test.
[c]Significant at the 5 percent level for a two-tailed test.
[d]Significant at the 10 percent level for a two-tailed test.

cerns about future harsh treatment of SO_2 emissions from the pulp and paper industry are reflected in the negative sign.

The coefficients on NATLANDS, AIRPOL, and WQUAL are not significant for a two-tailed test in the merged vote analysis, though they approach borderline significance for a one-tailed test. NATLANDS has a negative sign, which becomes highly significant in the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Senate vote equation, where WQUAL also becomes significant and positive. We interpret the negative coefficient on NATLANDS to indicate Senate concern for the enhancement of private land values, not for the protection of public lands. WQUAL indicates a concern for physically deteriorated waters, which could reflect an interest in appropriable rents.

The coefficient on AIRPOL is not significant, which implies that the measurements of the proportion of state populations exposed to higher levels of SO_2 are either not accurate or unimportant in motivating votes or that SO2PRCNT adjusts for those effects. In an attempt to isolate the effects of AIRPOL, we made additional estimates omitting SO2PRCNT. The level of significance of AIRPOL was even lower than before. AIRPOL is not highly correlated with SO2PRCNT. These results reinforce our inference that private interests, not public interests, are the motivating forces in the voting behavior analyzed.

The coefficient on REGION, the dummy variable set equal to one for voters representing one of the 31 states in the control region, is not significant in the merged equation but is significant and negative in the Senate estimate. We note that both REGION and NATLANDS are significant in that estimate, which suggests that REGION may isolate an additional Western state effect. We interpret these results to imply disinterest on the part of representatives from outside the affected region. The coefficients on LCVRATE and INCGRWTH are insignificant in all equations, suggesting that ideology does not matter and that income growth is reflected in other variables, perhaps SO2PRCNT.

Table 6 reports the OLS estimates with the statistically insignificant variables removed. These results underline the relative strength of the Senate equation. Finally, we report the truncated logit analysis in Table 7. Unfortunately, the number of observations were too few and the vote so skewed that the logit was unable to converge in estimating the Senate equation. The importance of variables in the merged and House equations is similar to those in the OLS estimates, however.

Caught between having too few observations for a thorough logit analysis on the one hand and statistically biased OLS estimates on the other, we prefer the OLS results, which are confirmed in a limited way by the logit. Although weaker than we would prefer, the statistical analysis of the only recorded votes on acid rain control reveals results supporting predictions based on the political economy of acid rain.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

TABLE 6

REGRESSION RESULTS WITH INSIGNIFICANT VARIABLES OMITTED

Variable	Coefficients for Merged Votes[a]	House	Senate
SO2PRCNT	-0.0649 (-2.708)[b]	-0.0612 (-2.944)[b]	
SENATE	0.4112 (3.104)[b]		
PARTY	0.3990 (3.041)[b]	0.8144 (4.777)[b]	
FPROD	-0.0692 (-1.631)		-0.0704 (-2.159)[c]
NATLANDS	-0.6826 (-1.377)		-2.0559 (-4.712)[b]
AIRPOL	0.0070 (1.305)		
WQUAL	0.0305 (1.624)		0.0540 (4.409)[b]
REGION			-0.2323 (-1.684)
R^2	0.5041	0.6208	0.6864
Adj R^2	0.3844	0.5734	0.5900
F Statistic	4.212	13.098	7.115
N	37	19	18

[a]Values of *t* statistics in parentheses.
[b]Significant at the 1 percent level for a two-tailed test.
[c]Significant at the 5 percent level for a two-tailed test.

Conclusion

The analyses of congressional votes on controlling acid rain imply that legislators support laws that protect appropriable rents in the coal producing regions, in the pulp and paper industry, and in the ownership of land. There is competition in the special-interest struggle for potential new property rights. When voting on acid rain bills, legislators in the House follow party guidance, while those in the Senate, which appear to follow chamber leadership, are not affected by party labels. Senators support the laws proposed, holding their political labels and other variables constant.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

TABLE 7

LOGIT TEST RESULTS FOR MERGED AND SEPARATE VOTES ON S768 AND HR5314

Variable	Coefficients for Merged Votes[a]	Probability Change	Coefficients House	Probability Change
SO2PRCNT	-0.6896 (-1.50)	-0.15	-0.3685 (-1.79)[d]	-0.09
SENATE	5.3258 (2.22)[c]			
PARTY	4.9713 (2.24)[c]		10.1616 (0.42)	
FPROD	-0.5885 (-1.22)	-0.13		
NATLANDS	-0.0977 (-1.59)	-0.02		
AIRPOL	0.1187 (0.68)	0.03		
WQUAL	0.3884 (1.75)[d]	0.08		
Model Chi^2	26.45[b]		15.40[b]	
N	37		19	

[a]Values of *t* statistic in parentheses.
[b]Significant at the 1 percent level.
[c]Significant at the 5 percent level for a two-tailed test.
[d]Significant at the 10 percent level for a two-tailed test.

The special-interest influences that creep into the voting process from industries not directly affected by the proposed legislation, the pulp and paper industry, appear to reflect concerns about future regulation. The political economy of acid rain is forward looking. We also observe that rents from private land appear to be more important than the protection of federally owned lands, which provide no appropriable rents. The Senate is also sensitive to water quality and acts to protect it, which may be saying that the fishing industry is protected. Again, there are potential private gains from protecting water quality, but we cannot find a similar argument for the protection of air quality. Ambient air quality across states does not seem to affect voting behavior, other things being equal. This is consistent with the lack of importance of ideological factors and the spread of SO_2 across both emitters and receivers of acid rain.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Why has an acid rain bill not come to the floor of Congress? Why has the Clean Air Act not been amended to resolve the acid rain problem? Our analysis suggests that the costs are simply too high. Party politics seems to have driven the votes on the two committee bills analyzed, but economic forces worked against an ultimate floor vote. At the time of the debate, the American economy was involved in significant restructuring, an adjustment process that placed heavy demands on the economies of the Midwest, the region most affected by the proposed legislation. Add to this uncertainty regarding the linkage between SO_2 and acid rain and enough inertia is formed to stall movement of the legislative engine.

References

Ackerman, Bruce A., and Hassler, William T. *Clean Coal/Dirty Air*. New Haven: Yale University Press, 1981.

Brady, Gordon. "The Cost of Acid Rain Legislation." Paper presented at the Department of the Interior and Council on Environmental Quality conference on emissions trading, July 1984.

Brown, Susan. "International—United States Air Pollution Control and the Acid Rain Phenomenon." *Natural Resources Journal* 21 (July 1981):631–45.

Buchanan, James M., and Stubblebine, William Craig. "Externality." *Economica* 29 (November 1962):371–84.

Coase, Ronald H. "The Problem of Social Cost." *Journal of Law and Economics* 3 (October 1960):1–44.

Congressional Research Service. *Acid Rain: A Survey of Data and Current Analyses*. Washington, D.C.: Government Printing Office, 1984.

Congressional Research Service. *Major Legislation of the Congress*. Washington, D.C.: Government Printing Office, 1980–86.

Cowling, Ellis B. "Acid Precipitation in Historical Perspective." *Environmental Science and Technology* 16 (1982):110a–23a.

Crandall, Robert W. *Controlling Industrial Pollution: The Economics and Politics of Clean Air*. Washington, D.C.: Brookings Institution, 1983.

Crandall, Robert W. "An Acid Test for Congress." *Regulation* 8 (September/December 1984):21–28.

Davis, Joseph A. "Clean Air Reauthorization with New Acid Rain Controls Approved by Senate Panel." *Congressional Quarterly* 42 (17 March 1984):621–22.

"Environmental Protection Agency Programs: Congressional Activities." *Digest of Public Bills and Resolutions* 98th Cong., 2d sess., no. 1, pt. 1: 185–91, E478–E479 (1984).

Frendreis, John P., and Waterman, Richard W. "PAC Contributions and Legislative Behavior: Senate Voting on Trucking Deregulation." *Social Science Quarterly* 66 (June 1985):401–12.

Gordon, Richard L. "Hobbling Coal—Or How to Serve Two Masters Poorly." *Regulation* 2 (July/August 1978):36–45.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Kalt, Joseph P. "The Costs and Benefits of Federal Regulation of Coal Strip Mining." *Natural Resources Journal* 23 (October 1983):893–915.

Kalt, Joseph P., and Zupan, Mark A. "Capture and Ideology in the Economic Theory of Politics." *American Economic Review* 74 (June 1984):279–300.

Kau, James B., and Rubin, Paul H. "Self-interest, Ideology, and Logrolling in Congressional Voting." *Journal of Law and Economics* 22 (October 1979):365–84.

Miller, James C. III. "Is Organized Labor Rational in Supporting OSHA?" *Southern Economic Journal* 50 (January 1984): 881–85.

National Economics Research Associates, Inc. *A Report on the Results from Edison Electric Institute Study of the Impacts of the Senate Committee on Environment and Public Works Bill on Acid Rain Legislation (S768).* Washington, D.C.:1983.

O'Donnel, Frank. "Acid Rain Controls: Is There a 'Sensible' Compromise?" *Sierra Club Bulletin,* November-December 1983, pp. 36–38.

Pasztor, Andy. "Five States, 3 Environmental Groups Plan Suit to Force EPA Action on Acid Rain." *Wall Street Journal,* 19 January 1984, p. 8.

Peltzman, Sam. "Toward a More General Theory of Regulation." *Journal of Law and Economics* 19 (August 1976):211–40.

Peltzman, Sam. "Constituent Interest and Congressional Voting." *Journal of Law and Economics* 27 (April 1984):181–210.

Record, Frank. *Acid Rain Information Book.* Park Ridge, N.J.: Noyes Data Corp., 1982.

Silberberg, Eugene, and Nelson, Douglas. "National Defense and Legislative Choice." Typescript, 1985.

Stigler, George. "The Theory of Economic Regulation." *Bell Journal of Economics* 2 (Spring 1971):3–21.

U.S. Bureau of Labor Statistics. *Employment and Wages, Annual Averages.* Washington, D.C.: Government Printing Office, 1982.

U.S. Department of the Interior. Geological Survey. *Evidence for Acid Precipitation-Induced Trends in Stream Chemistry at Hydrologic Bench-Mark Stations. Geological Survey Circular 910.* Washington, D.C.: Government Printing Office, 1983.

U.S. Department of the Interior. Geological Survey. *An Evaluation of Trends in the Acidity of Precipitation and the Related Acidification of Surface Water in North America. Geological Survey Water Supply Paper 2249.* Washington, D.C.: Government Printing Office, 1983b.

U.S. General Accounting Office. *The Debate Over Acid Precipitation: Opposing Views, Status of Research.* Washington, D.C., 1981.

U.S. Office of Technology Assessment. *Additional Evaluation of HR3400: The National Acid Deposition Control Act of 1983.* Mimeo, 1983.

U.S. Office of Technology Assessment. *Acid Rain and Transported Air Pollutants: Implications for Public Policy.* Washington, D.C.: Government Printing Office, 1984.

Wetstone, Gregory, and Foster, Sarah. "Acid Precipitation: What Is It Doing to Our Forests?" *Environment* 25 (May 1983):10–12, 38–40.

White, Lawrence J. *Reforming Regulation.* Englewood Cliffs, N.J.: Prentice-Hall, 1981.

Yandle, Bruce. "Sulfur Dioxide: State versus Federal Control." *Journal of Energy and Development* 10 (Autumn 1984):63–72.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

BOOK REVIEWS

A Conflict of Visions
Thomas Sowell
New York: William Morrow, 1987, 273 pp.

In his most recent book, Sowell describes an observation that is so familiar one rarely reflects upon it:

> One of the curious things about political opinions is how often the same people line up on opposite sides of different issues. The issues themselves may have no intrinsic connection with each other. They may range from military spending to drug laws to monetary policy to education. Yet the same familiar faces can be found glaring at each other from opposite sides of the political fence, again and again [p. 13].

A Conflict of Visions reflects upon this common observation; it is an inquiry into the reasons why we so often find such a remarkable correlation in people's views across a broad array of issues. As Sowell conjectures, the commonly observable correlation and clustering in political opinions cannot be understood as simply reflecting some underlying structure of interests. A more appropriate account, he argues, must be given in terms of certain fundamental ideas or premises—referred to as "visions"—which, largely unarticulated, are behind and give coherence to people's particular political opinions.

A *vision* in Sowell's terminology is a "sense of how the world works," a "sense of reality and causation." Visions are theoretical constructs but they are much broader and more general than what we ordinarily refer to as theories. They are the "foundations on which theories are built," yet they are much more remote from and only quite indirectly related to observed reality. This makes them far less exposed to and vulnerable to potential counterevidence, a fact that accounts for their apparent robustness and stability.

While an almost infinite differentiation in visions is, in principle, conceivable, Sowell supposes that many differences and conflicts in social and political thought, past and present, can, in fact, be understood as ramifications emerging from two systematically opposed kinds of visions which he contrasts as the "constrained" and "unconstrained" types. The first part of Sowell's book (chaps. 1–5) aims at a general characterization of the two conflicting visions, citing authors like Smith, Burke, Friedman, or Hayek as exemplifying the constrained variety and Rousseau, Godwin, Veblen, Galbraith, and others as representing the opposite prospects. The second part (chaps. 6–9) looks into applications of the two visions to the issues of equality, of power, and of justice.

The substantive conflict between the constrained and the unconstrained vision is identified by Sowell in their different conceptions of "the nature of

Cato Journal, Vol. 7, No. 2 (Fall 1987). Copyright © Cato Institute. All rights reserved.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

man, the nature of knowledge, and the nature of social processes." Viewing the motivational limitations of human nature as given and placing less trust in abstract reason than in common experience, the constrained vision emphasizes the function of rules and institutions in guiding social and political processes. In contrast, the characteristic features of the unconstrained vision are its belief in the perfectibility of man, its confidence in the power of reason, and the role it assigns to discretionary planning and deliberate design in producing the "common good."

Like his earlier *Knowledge and Decision* (1980) Sowell's new book is very much in a Hayekian spirit and, in fact, in reading *A Conflict of Visions* one feels strongly reminded of a theme that is central to many of Hayek's writings, namely, his distinction between two traditions in social and philosophical thought that he discusses under labels such as "French and British Enlightenment," "True and False Individualism," and "Kinds of Rationalism" (see *Individualism and Economic Order*, chap. 1; *The Constitution of Liberty*, chap. 4; *Studies in Philosophy, Politics and Economics*, chap. 5). Sowell's description of the "unconstrained vision" actually reads like a somewhat popularized restatement of and variation on Hayek's critical account of "constructivist rationalism," that is, the view that deliberate organization and rational construction are the principal means for creating a desirable social order. The same kinds of arguments are central to both conceptions and a certain ambiguity that characterizes Hayek's account is present, in even intensified proportions, in Sowell's assessment as well.

Boiled down to its very core, Sowell's characterization of the unconstrained vision of politics reads like this: In this vision politics is a matter of implementing some knowable and identifiable "social good"—such as the Marxian ideal of a classless society—rather than a matter of reconciling potentially conflicting interests and perceptions of what the "social good" might be. Accordingly, its focus is on the "who shall rule" question, and the logical answer to this question is that those whom are most competent in identifying the knowable "good"—the "philosopher king," the "enlightened avant-garde"—ought to be in control. Quite naturally, then, such a view has no systematic place for the idea of subjecting the political process to general rules and institutional constraints. On the contrary, such constraints are only perceived as hindering or obstructing an effective implementation of the "known good."

Though Sowell's stated purpose is merely to portray the two visions rather than to "determine their validity" (p. 224), there can be no doubt about his judgment in this matter. Paralleling Hayek's criticism of constructivist rationalism, Sowell clearly wants to argue that—in contrast to the "abuse of reason" in the unconstrained vision—the constrained vision embodies a sounder understanding of the proper scope and limits of reason and rational design in social and political matters. It is here that Sowell's argument suffers from a fundamental ambiguity, an ambiguity that mirrors an indistinctness in the Hayekian concept of constructivist rationalism. In his use of this concept Hayek fails sufficiently to distinguish between two issues, namely, the issue

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

of social and economic planning in the sense of direct control over outcomes, and the issue of rationally judging and shaping the institutional framework within which social interaction takes place. These two issues are of a quite different nature and what qualifies as "abuse of reason" may be quite different in each case. In fact, while clearly rejecting the social planning mentality, Hayek explicitly recognizes that rational evaluation and deliberate reform of the institutional framework are not only consistent with an appreciation of a spontaneous market order and rule-guided social processes in general, but are the principal means for improving such an order and such processes. Admittedly, though, arguments of this kind may be more easily found in Hayek's earlier writings (for example, *Individualism and Economic Order*, chap. 6). In his later publications the emphasis has been clearly shifted to a notion of *cultural evolution* which seems to suggest passive acquiescence in some, barely specified, spontaneous process at the institutional level itself and to leave little room for any rational evaluation of and reform in rules and institutions.

The failure to separate the two varieties of "constructivist rationalism" is even more characteristic of Sowell's book. Sowell fails systematically to distinguish between the issue of whether relying on general rules, as opposed to direct planning of outcomes, is a superior way of organizing our social affairs, and the issue of whether we can and ought to analyze rationally the "quality" of rules and engage in deliberate reform of rules. It is this failure that gives a quite irritating anti-rationalist flavor to Sowell's portrayal of the *constrained vision*, a flavor that reflects and intensifies the anti-rationalist tendencies in Hayek's notion of cultural evolution. Sowell's portrayal invokes again and again the same formulas—"power of unarticulated processes," "naturally evolved systemic processes," "implicit wisdom of systemically evolved procedures," and so on—without ever really addressing the issue of what the characteristic features of those processes are that the constrained vision would recommend us to rely on. These formulas are certainly not meant to imply that any "unarticulated process"—that is, any process in which deliberate coordination of individual efforts is absent—operates in a desirable way. Yet, if only certain kinds of processes qualify as "beneficially working," then our prime attention has to be on specifying the characteristics of "good" processes and on explaining why they can be expected to work beneficially. In other words, rational comparative analysis of the working properties of alternative systems of rules and institutional frameworks would have to be a principal concern of a "constrained vision." There is almost nothing of this, however, in Sowell's treatise and it is quite indicative that his book contains no reference to Buchanan whose work is most pertinent to these issues.

Certainly, there are general references to the role of institutional constraints, to the "systemic effect of competition" (p. 57), and to incentive structures as "the crucial characteristic of any social system" (p. 86). Also, Sowell repeatedly argues that the constrained vision is interested in "the relative merits of alternative processes" (p. 130) and that it "emphasizes

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

incentives to lead to socially desirable results" (p. 182). But there is no systematic discussion on the issue of how a social community should go about the task of identifying and implementing a desirable framework of rules and institutions. The potential role of collective decisions on institutional matters is never really discussed in Sowell's treatise. In fact, Sowell does not seem to see any such role (see, for example, pp. 98f., 109, 112f., 116), and statements like "There are no 'constitutional choices' to make, if man cannot choose social results anyway" (p. 201), as well as his comments on Rawls (pp. 103f., 172f., 194f.), indicate that the whole notion of choice among rules and institutions seems to be alien to him.

Sowell's *A Conflict of Visions* is, on the whole, a very stimulating book and it argues a very important point, namely, that the political struggles which will shape our future social and political order are not only, and maybe not even primarily, driven by identifiable interests and by rent-seeking activities that use politics as a pure machinery for the redistribution of material wealth. Sowell rightly reminds us of the genuine power of ideas and visions in the political arena. Yet, rather than attempting to give an overall assessment of the merits and shortcomings of *A Conflict of Visions*, I have focused my review on one aspect that seems to me to be characteristic of certain antirationalist tendencies in the modern tradition of classical liberalism, tendencies that have been fueled, unfortunately, by certain ambiguities in Hayek's critique of "constructivist rationalism" and his arguments on "cultural evolution." These tendencies are present in interpretations of the spontaneous order and spontaneous process notion that sound as if the absence of collective decisions and deliberate coordination were sufficient to guarantee a beneficial working of social processes, without any further need to look into the specific characteristics of these processes. Adam Smith used the concept of the "invisible hand" as a label for a kind of social mechanism that he carefully specified and the working principles of which he very rationally analyzed. He not simply *postulated* that "spontaneous" processes have beneficial characteristics; he also systematically explained under what conditions, and why, this is so. Some of his modern followers tend to invoke an invisible-hand rhetoric that must provoke sarcastic comments such as Dworkin's remark on "the silly faith that ethics as well as economics moves by an invisible hand . . . to a frictionless utopia where everyone is better off than he was before" (quoted in Sowell, p. 53). If the spontaneous order notion and the invisible-hand concept are not to degenerate into a matter of faith, let alone of "silly faith," their modern advocates have to continue the type of rational analysis in which the 18th century's classical liberals engaged. In particular, they ought rationally to analyze and evaluate comparatively the working properties of alternative institutional arrangements. They should not acquiesce in some unanalyzed process of evolution through which, for some mystic reason, "the competition of institutions and whole societies" will lead "to a general survival of more effective collections of cultural traits" (p. 41).

Viktor Vanberg
Center for Study of Public Choice
George Mason University

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Catholic Bishops and the Economy: A Debate
Douglas Rasmussen and James Sterba
New Brunswick: Transactions Books, 1987, 118 pp.

James Sterba and Douglas Rasmussen, both philosophy professors at Catholic universities and "steeped in the Catholic tradition," according to the introduction, set out in this book to debate the philosophical foundations of the Catholic bishops' pastoral letter on the U.S. economy, published in its final form in 1986. What emerges is a disappointingly small amount of debate about the letter itself.

The first problem is that Sterba, who wants to defend the bishops' policy recommendations, leads off. But a defense presupposes an attack. Since Rasmussen has not yet attacked, Sterba must first construct the arguments he wants to refute. He does not confront the criticisms of a real opponent until his eight-page "Response to Rasmussen" at the end of the book, and even then the response is directed more toward Sterba's own version of a libertarian position than to Rasmussen's actual arguments.

Sterba does spend a few pages near the beginning of his essay answering some of those who have argued that the bishops' policy recommendations will not work. But the treatment is superficial as well as brief, and obviously a mere preliminary to what Sterba takes as his main assignment: a *philosophical* defense of the economic pastoral.

That is the second problem. What constitutes a specifically philosophic defense of a set of economic policy recommendations? Can a philosophic argument be separated from theological and economic arguments when discussing the implications of a theological perspective for economic policy? There are indeed ways of arguing that could be called peculiarly philosophic because they only impress professional philosophers. Unfortunately, they rarely *persuade* anyone, professional philosophers least of all. Sterba's "philosophical defense" is a prime example. He attempts to prove that libertarians, socialists, and welfare liberals who value human dignity will all consent to the bishops' policy proposals once they have been shown the implications of their own positions. I leave it to the reader to decide how many people will change their views about welfare legislation upon being shown that neither John Rawls nor John Harsanyi has quite correctly grasped the implications of choice behind the veil of ignorance.

Rasmussen has an easier task because he can attack the arguments of the letter itself. He does so by attempting to show "that the Catholic Bishops have failed to grasp both the fundamental character of human dignity and the nature of the free market." He begins by accepting the principle of human dignity and the normative foundation for the bishops' understanding of that dignity, namely, the belief that human beings have the natural function or purpose of "flourishing" or achieving "self-actualization." But he denies that the rights and duties asserted by the bishops follow from the dignity humans possess and claims that they are in fact antithetical to it.

The bishops hold that because flourishing requires such goods as food, clothing, shelter, rest, medical care, education, employment, and healthful

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

working conditions, these are all human rights. Justice therefore requires that each individual be able to claim all of these, in adequate amounts, as a matter of legally enforceable right, and, as a necessary consequence, that others have a legally enforceable obligation to supply all of these goods or the means to obtain them. The assertion of such positive rights, however, entails the denial of negative human rights. People cannot have the right to use their own time and other resources as they choose, free from interference by others, if others have the right to commandeer those resources whenever they lack the means necessary to their flourishing.

Rasmussen contends that, on the bishops' own normative grounds, human beings are in justice entitled to negative rights that preclude the positive rights for which the bishops argue. Any positive rights that people possess must be derived from the negative rights that are the precondition of self-directedness or autonomy, an essential constituent of human flourishing.

Sterba's response seizes upon Rasmussen's contention that negative rights are absolute but can nonetheless be disregarded in emergencies, and argues in effect that society will be in a chronic state of emergency unless it contains the sort of welfare institutions that Sterba himself favors. Rasmussen's response objects to Sterba's conception of liberty as the power to do whatever one wants, unconstrained by other persons. The liberty for which Rasmussen contends is a normative conception; liberty requires only that people be unconstrained by others in doing what they have a *right* to do. Mere wants do not generate rights.

I would have liked to have seen much more discussion of this last issue. Everyone is in favor of liberty, but as Rasmussen notes, liberty is not a univocal notion. The argument over positive versus negative rights raises fundamental questions about the proper way to define liberty. It would have been instructive to see Sterba and Rasmussen elaborate, apply, and defend their conflicting definitions of liberty in debating the bishops' proposals. That would have compelled them to pay attention to questions of practical implementation and probable consequences, matters into which Sterba in particular seems reluctant to enter. While that would also have carried them outside the realm of philosophy narrowly conceived, philosophy cannot be narrowly conceived if it is going to assist in the discussion of public policy.

Paul Heyne
University of Washington

Impulse to Revolution in Latin America
Jeffrey W. Barrett
New York: Praeger, 1985, 360 pp.

Jeffrey Barrett's volume is part of an encouraging trend among scholars to view the economic development problems of Latin America in more realistic terms. By employing an analytical framework that emphasizes the role played by indigenous political and cultural values, Barrett provides a useful corrective to prevailing leftist theories. In particular, he effectively undermines

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the simplistic notion that the disappointing pace of economic progress throughout Latin America is due to exploitation on the part of multinational corporations and the region's dependent, "colonial" status with respect to the industrialized West.

Barrett provides a different and more compelling explanation. He contends that from the beginning, a number of "modernization-impeding" values have afflicted Latin American societies. These include an obsession with status (and the concomitant formation of a rigid status hierarchy), a pernicious envy of the economically successful, and the prevalence of conspicuous consumption rather than productive investment. Barrett makes the telling point that immigrants from societies where such destructive attitudes are less dominant have always occupied a disproportionate percentage of leadership positions in Latin American economies.

The woeful lack of economic development has produced an ongoing "identity crisis" in Latin American cultures, according to Barrett. Attempts to resolve that identity crisis have assumed a variety of forms. In the past, many Latin American modernists affected an extreme cosmopolitanism while others imitated the outward cultural forms of the United States and Europe. More recently, however, the trend has been toward a "reactive nationalism" which is characterized by a refusal to acknowledge the self-inflicted nature of the region's underdevelopment and, instead, to transfer responsibility for that situation abroad. Reactive nationalism, Barrett contends, creates an ideal environment for a totalitarian solution, either in the form of Peron-style fascism or the Marxist-Leninist variant exemplified by Castro's Cuba.

Barrett's argument is most persuasive when he examines the societal values that have molded Latin American behavior over centuries. The plethora of examples that he cites should render it impossible for critics to dismiss his thesis. Barrett does, however, lapse into a few questionable assertions even in this area of inquiry. The worst of these is his contention that excessive individualism has impeded modernization in Latin America. That allegation seems dubious in light of his overwhelming evidence concerning the deleterious role played by state paternalism and the presence of stifling public bureaucracies throughout the region. Moreover, anyone familiar with the cultural history of the United States and the prevalence of intense individualism during the 19th century—the period of most rapid industrialization—will be exceedingly skeptical of his theory.

The author's apparent infatuation with "community" and his corresponding hostility toward individualism leads him into an intellectual minefield. For example, despite a scathing critique of Leninist economic fallacies, Barrett inexplicably finds much to be admired in the Castro regime's campaign to instill a sense of discipline and community spirit in the supposedly anarchic Cuban masses. The recipients of such regimentation, one suspects, might view the situation differently.

Barrett commits even more egregious sins when he delves into areas in which he clearly lacks expertise. While his effort to dispel the myth that Latin America's woes are entirely the fault of Yankee imperialism is com-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

mendable, his attempt to exculpate all U.S. conduct is considerably less so. Barrett's casual dismissal of charges that the Nixon administration deliberately destabilized the Chilean economy in order to weaken the regime of Salvador Allende distorts the historical record. Worse still is his contention that the Eisenhower administration merely provided support for "indigenous anti-communist factions in Guatemala" against a regime of "coffeehouse communists" (p. 174). In reality, the United States cynically orchestrated a coup against the democratically elected government of Jacobo Arbenz-Guzman. Barrett's apologia betrays both a lack of knowledge and a disturbing insensitivity. Consulting such works as Blanche Wiesen Cook's *The Declassified Eisenhower* and Richard H. Immerman's *The CIA in Guatemala* might have impelled him to reach a less sanguine and far more accurate conclusion.

Such lapses detract significantly from what would otherwise have been a superb book. Nonetheless, Barrett does advance a provocative and generally well-argued thesis to explain the retarded pace of economic development in Latin America. Despite its flaws, *Impulse to Revolution* is a worthwhile contribution to a small but growing body of literature on hemispheric issues exemplified by the works of perceptive writers such as Carlos Rangel and Michael Novak.

Ted Galen Carpenter
Director of Foreign Policy Studies
Cato Institute

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

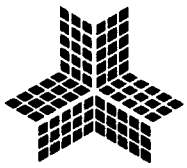
E X P A N D
YOUR PROFESSIONAL HORIZONS

Enjoy the many benefits of membership in the National Association of Business Economists (NABE)

Today, because of fluctuating business conditions, the business economist's world is rapidly changing. To stay on top, you need to keep abreast of current economic thought and comment, of data, trends and policies. You need access to the ideas and opinions of fellow professionals in the industry. Membership in the NABE can help you fine-tune your skills, and broaden your professional outlook.

The NABE serves the needs of economists at many levels: private industry, non-profit and trade organizations, consultants, government and university researchers. As a member, you receive the benefit of many services and activities including:

- Business journal: Published four times yearly, the NABE's prestigious *Business Economics* features outstanding articles on applied economics, plus solicited and contributed manuscripts and annual meeting papers.
- Newsletter: Distributed bi-monthly, the *NABE News* provides timely feature articles, news of local NABE chapters and roundtables, and reviews of seminars and meetings.
- Outlook Survey: Results of NABE's quarterly survey offers projections on macro economic variables--GNP, CPI, auto sales, housing starts, interest rates and others.
- Placement assistance: *Employment Opportunities*, a quarterly listing and also available continually on NABE's electronic bulletin board, is an excellent source of job openings. In addition, the Association's annual Membership Directory is an invaluable reference for employment purposes.
- Salary Survey: The NABE publishes a biennial Salary Survey, the only authoritative source of business economists' salaries.
- Annual Meetings: Each fall, through the NABE's forum, the business economic community focuses on the coming year's economic outlook, plus data, theory and important economic policy issues. A late winter Washington seminar examines the key economic policy issues for the coming year.



CLIP AND MAIL

☐ Yes, I wish to become a member of the National Association of Business Economists.

Check enclosed ($55) for regular individual membership, USA & Canada; $75 all other countries. Membership includes your subscription to *Business Economics, NABE News* and *Employment Opportunities.*

☐ ($30) Subscription to *Business Economics* only, USA & Canada; $45 all other countries.

PLEASE PRINT

Name_____

Title _____

Organization _____

Street Address _____

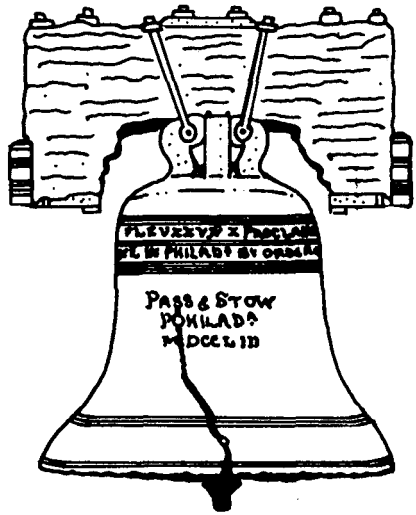
City _____ State _____ Zip _____

Mail to: **National Association of Business Economists**
28349 Chagrin Blvd. Cleveland, OH 44122-4589
Phone: 216/464-7986

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

TWENTY-SIXTH
ATLANTIC ECONOMIC CONFERENCE
INVITATION FOR PAPERS
OCTOBER 6-9, 1988

PHILADELPHIA



"THE CHALLENGE OF INDEPENDENCE

Author Submission Fee

All authors wishing to present a paper should include a submission fee of $30 (U.S.) for each paper. To avoid a bank collection charge, all foreign and Canadian checks should be drawn on a U.S. bank. Submission fees are not refundable. If there is more than one author per paper, only one submission fee is required.

Authors

Those wishing to have a paper considered for acceptance must submit two copies of a 500 word summary with a separate cover sheet listing: (1) Location of conference to be considered for; (2) Name of author(s); (3) Institution of affiliation; (4) Mailing address of author(s); (5) Phone number of author(s); (6) Number and name of the JEL categories under which the article primarily belongs.

Discussants and Chairmen

Those preferring to be a discussant or chair a session, please submit the following information: (1) Location of conference to be considered for; (2) Name; (3) Institution of affiliation; (4) Mailing address; (5) Phone number; (6) Preference for discussant, chairman, or both; (7) JEL number and name of your primary and secondary interests. Chairmen and discussants are not required to pay a submission fee.

All participants accepted on the program will be responsible for their own expenses and payment of the conference registration fee.

Submit To: John M. Virgo, Atlantic Economic Conference, Southern Illinois University, Campus Box 1101, Edwardsville, IL 62026-1101, U.S.A.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

JOURNAL OF LABOR RESEARCH

Selected Articles Forthcoming in Volume IX, 1988

Grievance Initiation: A Literature Survey and Suggestions for Future Research	*Chalmer E. Labig, Jr.* *Charles R. Greer*
The Effect of Unionization on Labor Productivity: Some Additional Evidence	*C.A. Knox Lovell* *Robin C. Sickles* *Ronald S. Warren, Jr.*
A Cross Section Analysis of the Postwar Decline in American Trade Union Membership	*William J. Moore* *Robert J. Newman*
The Composition of Public Sector Compensation: The Effects of Unionization and Bureaucratic Size	*William J. Hunter* *Carol H. Rankin*
Labor Market Contracting and Wage Dispersion	*Sanford M. Jacoby* *Maury Y. Pearl*
The Office and Professional Employees International Union: From "Union Company Union to Independent Representative"	*Herbert R. Northrup* *Theresa Diss Greis* *Kay M. Dowgun*
Labor Arbitrators' Performance: Views from Union and Management Perspectives	*Donald P. Crane* *John B. Miner*
Workplace Hazards and Workers' Desires for Union Representation	*James C. Robinson*
Paying Dues to the Union: A Study of Blue-Collar Workers in a Right-to-Work Environment	*John M. Jermier* *Cynthia F. Cohen* *Jeannie Gaines*
Congressional Support for Unions' Positions Across Diverse Legislation	*Marick F. Masters* *Asghar Zardhooki*
Police Recognition Strikes: Illegal and Ill-Fated	*Casey Ichniowski*
Non-Clearing Labor Markets and Minority Employment in Municipal Government	*Rodolfo A. Gonzalez* *Stephen L. Mehay*
Wage Patterns: An Evolutionary Perspective	*John T. Addison* *John B. Chilton*
An Analysis of the Barriers to Women Becoming Union Officers	*Gary N. Chaison* *P. Andiappan*
Searching for the Effect of Unionism on the Wages of Union and Nonunion Workers	*Ronald L. Oaxaca* *Michael R. Ransom*
Unionism and Voter Turnout	*John Thomas Delaney* *Marick F. Masters* *Susan Schwochau*

The **Journal of Labor Research** is published quarterly by the Department of Economics of George Mason University. Subscriptions are on a calendar year basis and subscribers will receive all issues for the current year. Annual subscription rates are: individuals, $30.00; academic libraries, institutions, government agencies, and business firms, $65.00. Foreign subscribers add $5.00 to cover additional postage. All remittances should be made payable to **Journal of Labor Research**, Department of Economics, George Mason University, Fairfax, Virginia 22030.

Editorial correspondence and manuscripts should be sent to James T. Bennett, Editor, Journal of Labor Research, Department of Economics, George Mason University, Fairfax, VA 22030. Manuscripts should be submitted in triplicate with a 100 word abstract. A submission fee of $20.00 for nonsubscribers must accompany all manuscripts. Papers accepted for publication must conform to JLR style requirements; style sheet available on request.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

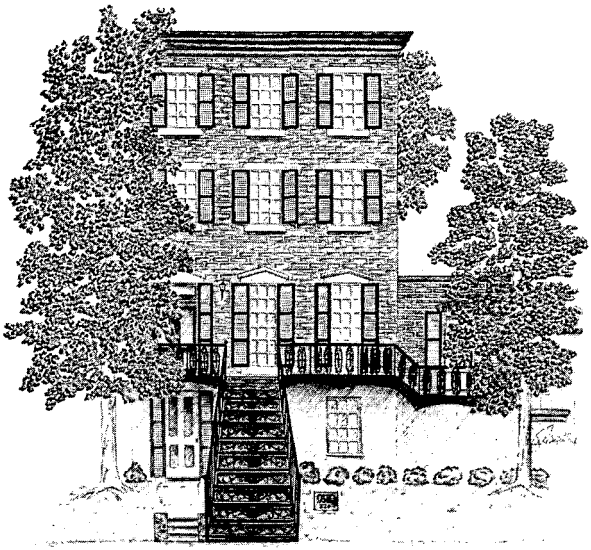
The Cato Institute

Founded in 1977, the Cato Institute is a nonpartisan public policy research foundation headquartered in Washington, D.C. The Institute is named for *Cato's Letters*, libertarian pamphlets that helped lay the philosophical foundation for the American Revolution.

The Cato Institute seeks to broaden the parameters of public policy debate to allow consideration of more options that are consistent with the traditional American principles of limited government, individual liberty, and peace. Toward that goal, the Institute strives to achieve a greater involvement of the intelligent, concerned lay public in questions of policy and the proper role of government.

The Cato Institute undertakes an extensive publications program dealing with the complete spectrum of policy issues. Books, monographs, and shorter studies are commissioned to examine the federal budget, Social Security, monetary policy, natural resource policy, military spending, regulation, NATO, international trade, and many other issues. Major policy conferences are held throughout the year, from which papers are published thrice yearly in the *Cato Journal*.

In order to maintain an independent posture, the Cato Institute accepts no government funding. Contributions are received from foundations, corporations, and individuals, and from the sale of publications. The Institute is a nonprofit, tax-exempt, educational foundation under Section 501(c)3 of the Internal Revenue Code.



The Watterston House headquarters of the Cato Institute

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

7^{00}

THE CALCULUS OF CONSENT

The attainment of consent is a costly process . . . and a recognition of this simple fact points directly toward an "economic" theory of constitutions. The individual will find it advantageous to agree in advance to certain rules . . . when the benefits are expected to exceed the costs. The "economic" theory that may be constructed out of an analysis of individual choice provides an explanation for the emergence of a political constitution from the discussion process conducted by free individuals attempting to formulate generally acceptable rules in their own long-term interest. It is to be emphasized that, in this constitutional discussion, the prospective utility of the individual participant must be more broadly conceived than in the collective-choice process that takes place *within defined rules*. Our theory of constitutional choice has normative implications only insofar as the underlying basis of individual consent is accepted.

—James M. Buchanan and Gordon Tullock

The Calculus of Consent
(Ann Arbor: University of Michigan
Press, 1962), p. 7.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED